“Don’t ask me, it was the trust”:

Rebalancing the rights to distributions between creditors and beneficiaries of trading trusts.

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"... in my judgment it is any event wrong to lift wholesale the detailed rules developed in the context of traditional trusts and then seek to apply them to trusts of quite a different kind. In the modern world the trust has become a valuable device in commercial and financial dealings. ... it is important, if the trust is not to be rendered commercially useless, to distinguish between the basic principles of trust law and those specialist rules developed in relation to traditional trusts which are applicable only to such trusts and the rationale of which has no application to trusts of quite a different kind."

Target Holding Limited v Redferns [1996] AC 421 at 435 per Lord Browne-Wilkinson.

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Introduction

There is nothing novel in a trustee operating a business. Prompted by perceived advantages however, such as tax mitigation,[1] a uniquely Australasian development[2] is the 'trading trust'. Its key distinguishing feature is that the office of trustee is taken by an incorporated limited liability company with few, if any, assets of its own; all assets appeared to be owned by the company are held on trust.[3] Typically, the beneficiaries are discretionary beneficiaries.[4] The end result is an amalgam of the inherent flexibility of the trust concept,[5] and the advantages of a distinct legal personality and limited liability offered by a company.[6]

From the perspective of the beneficial owners, trusts provide insulation from trust debts; that is the trustee's responsibility.[7] Trust law developed with an expectation of a responsible (more typically) individual acting as trustee.[8] Parties dealing with the trustee(s) had the comfort of their personal and unlimited liability (unless expressly

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[1] GE Dal Pont, *Equity and Trusts in Australia* (6th ed, Pyrmont, New South Wales, 2015) at 695; *Levin v Ikiua* [2010] 1 NZLR 400 (HC) at [102]; New Zealand Law Commission, *Court Jurisdiction, Trading trusts and other issues review: fifth issues paper* (NZLC IP28, 2011) ("fifth issues paper") at [6.13]-[6.15]; H.A.J. Ford and I.J. Hardingham "Trading Trusts: Rights and Liabilities of Beneficiaries" in Finn, *Equity and Commercial Relationships* (Sydney: Law Book Company, 1987) 48 at 50; BH McPherson "The Insolvent Trading Trust" in PD Finn (ed) *Essays in Equity* (Law Book Company, Sydney, 1985) 142 at 142.

[2] North America has seen the 'business trust' or 'Massachusetts trust' which is similar to the trading trust but has only found 'occasional popular appeal': Robert D Flannigan, "The Nature and Duration of the Business Trust (1982) 6 Est & Tr Q 181 at 181; In the UK the using of a trust to carry on an active business has been described an unusual: Lynton Tucker, Nicholas Le Poidevin and James Brightwell (eds) *Lewin on Trusts* (19th ed, Sweet & Maxwell, London, 2015) at [36-107].

[3] *Levin v Ikiua* (HC), above n 1, at [97]. There is no statutory definition of the trading trust and definitions can take a more wide or narrow stance. See for instance: NZLC, *fifth issues paper*, above n 1, at [6.6]-[6.10].

[4] *Levin v Ikiua* (HC), above n 1, at [100].

[5] Donovan Waters "The Trust in a Changed and Yet Changing World" (2008) JITCP 205 at 230.

[6] NZLC, *fifth issues paper*, above n 1, at [6.14].

[7] *Farhall v Farhall* (1871) L.R. 7 Ch App 123 at 126.

[8] *Commissioner of Inland Revenue v Chester Trustee Services Ltd* [2003] 1 NZLR 395 (CA) at [63].

excluded in the contract).[9] In turn, the trustee's personal liability was tempered by a right of indemnity out of trust assets.[10] Judicial recognition that the trustee's right of indemnity could be subrogated to trust creditors provided additional reassurance and means of recovery where personal liability was not adequate.[11]

In the context of the trading trust, however, a risk for creditors is the imposition of an asset-poor corporate trustee, but which may appear to have control over significant assets.[12] The personal liability of the trustee is effectively nullified by the use of an asset-less company. In this context, subrogation to the trustee's right of indemnity is crucial,[13] but, as shall be seen, easily defeated – for example, as a result of equity's protection of beneficiaries from trustee misfeasance.[14]

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[9] Trusts Act 2019, s 81 (coming into force 1 January 2021); *Re Graham, Pitt & Bennett* (1891) 9 NZLR 617. Clear words will be needed to exclude the trustee's personal liability: *Muir v City of Glasgow Bank* (1879) 4 App CAS 337; *Re Robinson's Settlement* [1912] 1 Ch 717 at 728-9; *Helvetic Investment Corp v Knight* [1982] 7 ACLR 225 at 228.

[10] Trusts Act, s 81; *Worrall v Harford* (1802) 8 Ves 4, 8; 32 ER 250, 252; *Re Johnson* (1880) 15 Ch.D. 548.

[11] *Re Johnson*, above n 10; McPherson, above n 1, at 150; Tucker, Poidevin and Brightwell (eds), above n 2, at [21-38]; Daryl R Williams "Winding up Trading Trusts: Rights of Creditors and Beneficiaries" (1983) 50 ALJ 273 at 275; Nuncio D'Angelo "The Trust: Evolution from guardian to risk-taker, and how a lagging insolvency law framework has left financers and other stakeholders in peril" (2009) 20 JBFLP 278 at 289; Australian Law Reform Commission, *General Insolvency Inquiry* (No 45) (Canberra: Australian Government Public Service, 1988) at 249.

[12] H.A.J. Ford "Trading Trusts and Creditors Rights" (1981) 13(1) MULR 1; NZLC, *fifth issues paper*, above n 1, at [7.1]; Kalev Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis" (2011) 17 Trusts and Trustees 185 at 190; Williams "Winding up Trading Trusts: Rights of Creditors and Beneficiaries", above n 11, at 279; Kalev Crossland "Trading Trusts" in Paul Heath and Michael Whale (eds), *Insolvency Law in New Zealand* (3rd ed, Lexis Nexis NZ Limited, Wellington, 2018) at [46.4].

[13] Ford and Hardingham, above n 1, at 50.

[14] Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 186; Alastair Hudson "The Regulation of Trustees" in Martin Dixon and Gerwyn Griffiths, *Contemporary Perspective on Property, Equity, and Trust Law* (Oxford: Oxford University Press, 2007) 163 at 168-173; Donovan Waters, 'Convergence in Divergence: Civil and Common Law' in D Hayton (ed), *Extending the Boundaries of Trusts and Similar Ring-Fenced Funds*, (Kluwer Law International, The Hague 2002) 59 at 78.

This dissertation explores the ability of the trading trust to disadvantage its creditors.[15] The Companies Act 1993 ("the Act" or "CA") offers some avenues of relief for the creditor. For example, the potential of recovery from the trustee's directors for breach of directorial duty (assuming, of course, there is a breach),[16] or a payment to a creditor contrary to the Act's 'voidable preference regime'.[17] But while the Act protects creditors from distributions of company property at a time when the company is insolvent – through the conferral of a right of recovery against the shareholders,[18] this regime is restricted to company property, not trust property.[19] The vulnerability of trading trust creditors to distributions is reinforced by case law which suggests that the corporate trustee is free to distribute trust property to beneficiaries, without the beneficiaries being personally liable for repayment (barring claims such as dishonest assistance or knowing receipt).[20]

Although trading trusts are functionally and economically similar to companies in undertaking various forms of business,[21] the result is that creditors of trading trusts are at a disadvantage when compared to ordinary company creditors, based on the lack of a distribution regime. If full recovery from the directors is not possible, creditors confronted by an insolvent corporate trustee are reliant upon subrogation to the trustee's right of indemnity. This is a derivative right[22] and may have been rendered valueless by

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[15] Reference to the trust creditor, trading trust creditor or other similar terminology is short hand for contracting with a party in their capacity as trustee. As a trust is not a legal entity, the party contracts with the trustee personally.

[16] Paul Heath "Bringing Trading Trusts into the Company Line" (2010) 3 NZLR 519 at 537-539. For instance, *NZ Natural Therapy Ltd (in liq) v Little* [2017] NZHC 1416.

[17] Companies Act 1993, ss 292-296; Heath "Bringing Trading Trusts into the Company Line", above n 16, at 533-536 citing *Anzani Investment Ltd v Official Assignee* [2008] NZCA 144 affirmed in *McIntosh v Fisk* [2017] NZSC 78, [2017] 1 NZLR 863.

[18] Companies Act, s 56.

[19] *Levin v Ikiua* (HC), above n 1, at [108].

[20] *Levin v Ikiua* (HC), above n 1, at [134]-[135].

[21] Waters, above n 14, at 78; Nuncio D'Angelo "the trust as a surrogate company: the challenge of insolvency" 3 J Eq (2014) 299, at 305.

[22] *Ex parte Edmonds* (1862) 4 De GF & J 488 at 489; *Re Firth* [1902] 1 Ch. 342 at 346.

way of distributions of trust property to beneficiaries, which reduces the trust assets that a creditor may have redress to.[23]

Equity may yet provide relief for the creditor. In *Re Diplock*[24] the House of Lords recognised, albeit in the context of the administration of deceased estates, that recipients of a wrongful distribution of property may become personally for repayment. It may be possible to persuade a New Zealand court to extend this remedy to creditors of a trading trust.[25] Although it is submitted that the reasoning in *Diplock* is just as applicable to trusts, statutory reform through the incorporation of *Diplock* into the Trusts Act 2019 ("TA") is preferable; thereby reducing uncertainty in the law and saving unnecessary litigation.[26]

Chapter One outlines trust law principles regarding the position of creditors and creditor remedies.

Chapter Two reviews the application of these principles to creditors of a trading trust. It highlights the additional risks an asset-less corporate trustee poses for the creditor (even more so as the creditor may believe they are engaging with a traditional company).

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[23] For instance, *Levin v Ikiua* (HC), above n 1, at [94]; *Burns v Leda Holdings Pty Ltd* [1988] 1 Qd R 214, 89 FLR 365; *Ron Kingham Real Estate Pty Ltd v Edgar* [1999] 2 Qd R 439. Identified as a problem in Jeff Jenny and Jared Ormsby "Trading Trusts" in Andrew S Butler (ed), *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 415 at 463 and Lynne Taylor and Grant Slevin, *The Law of Insolvency in New Zealand* (Wellington, New Zealand: Thomson Reuters, 2016) at 1190.

[24] *Re Diplock; Diplock v Wintle* [1948] Ch 465 affirmed by the House of Lords in *Ministry of Health v Simpson* [1951] AC 251; (1950) 2 All ER 1137. Reference to this case and line of authority will be to *Diplock* as is common in most texts.

[25] Courts and academics have considered the extension of *Diplock* outside the administration of estates: *Ron Kingham Real Estate Pty Ltd v Edgar*, above n 23; *Butler v Broadhead* [1974] 3 WLR 27; *Re J Leslie Engineers Co Ltd* [1976] 2 All ER 85; [1976] 1 WLR 292; *Halsbury's Laws of England* (5th ed, 2019) vol 98 Trusts and Powers at [692]; *Halsbury's Laws of Australia* (reissue, 1995) vol 27 Trusts at [430-5630]; J. D. Heydon and M.J. Leeming, *Jacobs' Law of Trusts in Australia* (7th ed, Sydney: LexisNexis Buttersworths, 2006) at [2320]; HAJ Ford & WA Lee, *Principles of the Law of Trusts* (2nd ed, Sydney: Law Book Co, 1990 at [1730]; Robert Goff and Gareth H. Jones, *The Law of Restitution* (7th ed, London: Sweet & Maxwell, 2007) at [30-002]-[30-003].

[26] The Queensland legislature has done this: Trusts Act 1973 (Qld), s 113.

Chapter Three reviews key provisions in the Act designed for creditor protection. Some, such as the duties of a director, are able to meet some of the challenges of the trading trust, but the lack of a statutory regime to recover distributions of trust property from the recipient is a fundamental lacuna in the law.

Chapter Four seeks to remedy this gap. It will be demonstrated that the reasoning in *Diplock* is applicable to trusts and trading trusts, and can provide the creditor with a direct personal claim against the recipient beneficiaries.

The fifth and final Chapter considers statutory reform (and the advantages thereof) of regulating distributions of trust property.

While still a trust, the trading trust is a fundamental departure from the traditional trust,[27] to which the law should respond. Traditional trust law principles are inadequate in dealing with the trading trust. So too, while the distribution regime is a key deployment in the Act in offering protection against insolvent distributions,[28] it offers no protection for trading trust creditors. The result is that the trading trust creditor is more vulnerable to loss than either the creditor of the traditional trust with its human trustee(s) and creditors of traditional companies. There is no reason for this.

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[27] D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 302; Taylor and Slevin, above n 23, at 1188.

[28] New Zealand Law Commission, *Company Law Reform and Restatement* (NZLC R9, 1989) at [330]; Neil Campbell "Distributions" in Peter Watts, N. R. Campbell and Christopher Hare *Company Law in New Zealand* (2nd ed, Lexis Nexis NZ Ltd, Wellington, 2016) 179 at 181.

I The Creditor of the Trustee

This Chapter outlines the trustee's personal liability, their right of indemnity and the creditor's subrogation to this right. Claims against the trustee and to their right of indemnity is the traditional means in which a trustee's creditor would seek redress. Being clear on such principles is crucial in understanding the problem of the trading trust not being caught by such orthodox principles. Principles regarding the creditor's ability to settle debts often display a protective bias in favour of the beneficiary over the creditor.[29]

A The Trustee's Personal Liability

Hart defined a trust as "… an obligation … whereby the obligor is bound to deal with property … for the benefit of certain persons …".[30] This obligation is the trust. A trust is not a distinct legal entity, but is indispensable from the trustee.[31] A creditor therefore contracts with the trustee and not the trust.

Accordingly, the default position is that a trustee is personally and fully liable for trust debts.[32] As this is the default position, it can be altered in the contract between the trustee and creditor;[33] clear words will be needed for this.[34]

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[29] UK Trust Law Committee *Rights of Creditors Against Trustees and Trust Funds* (Tolley Publishing, London, 1997) at [1.5]; Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 186; Hudson, above n 14, at 168-173; Waters, above n 14, at 78.

[30] Walter G. Hart "What is a Trust?" (1899) 15 LQR 294 at 301. This dissertation only concerns the express trust as it is necessary to conduct trading trust. Other forms of trust, such as the constructive or resulting trust, are outside the scope of this dissertation.

[31] *AMP General Insurance Ltd v Macalister Todd Phillips Bodkins* [2006] NZSC 105, [2007] 1 NZLR 485 at [42]; *Re Astor's Settlement* (1952) Ch. 534.

[32] *Re Graham, Pitt & Bennett*, above n 9; *Re Johnson*, above n 10; *Farhall v Farhall*, above n 7.

[33] *Lumsden v Buchanan* (1865) 4 Macq 950 (HC).

[34] Contracting along the lines of "as trustee and not otherwise" would be necessary to limit liability accordingly: *Re Robinson's Settlement*, above n 9, at 728-9; *Helvetic Investment Corp v Knight*, above n 9, at 228.

B The Trustee's Right of Indemnity

This initial position needed tempering to ensure the office of trustee is a tenable one.[35] Equity took the view that the trustee should be saved harmless from the obligations attaching to the office of trustee, and this indemnity is the price to be paid for the service of trustee.[36]

The are several instances of the trustee's indemnity. The primary instance is a right of indemnity out of trust assets for liabilities properly incurred.[37] Section 81 TA (see appendix) is the statutory recognition of the right already existing at common law.[38] The result: a trustee enjoys a right of recoupment (to be reimbursed out of trust assets for expenses paid for) or exoneration (to pay liabilities directly out of trust assets) for liabilities properly incurred.[39] This is an asset of the trustee.[40]

Another instance of the trustee's indemnity is to be indemnified by the beneficiaries personally when trust assets are not sufficient to meet liabilities.[41] The Privy Council in *Hardoon v Belilios* stated that the trustee's indemnity has never been limited to trust assets but extends to the beneficiary as an enforceable obligation in equity to indemnify the trustee.[42] This principle was "as old as trusts themselves."[43] There are several restrictions on this instance of indemnity which result in the beneficiary of the trading

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[35] *Re Beddoe* [1893] 1 Ch. 547 at 558; Taylor and Slevin, above n 23, at 1192; McPherson, above n 1, at 144.

[36] *Hardoon v Belilios*, [1901] AC 118 at 125; Heydon and Leeming, above n 25, at [2102].

[37] Trusts Act, s 81; Trustee Act 1956, s 38(2).

[38] *Re Johnson*, above n 10; *Worrall v Harford*, above n 10.

[39] The exception for the requirement of liabilities to be properly incurred is where the trustee has acted in good faith and the beneficiaries have benefitted, then the indemnity remains intact to the value of the enrichment: *Vyse v Foster* (1872) LR 8 Ch App 309.

[40] *Levin v Ikiua* (HC), above n 1, at [118].

[41] *Hardoon v Belilios*, above n 36; *JW Broomhead (Vic) Pty Ltd (in liq) v JW Broomhead Pty Ltd* [1985] VR 891; *Balkin v Peck* (1998) 43 NSWLR 706.

[42] *Hardoon v Belilios*, above n 36, at 124.

[43] At 124.

trust rarely being liable to indemnify the trustee.[44] In-depth discussion on these restrictions are best placed in Chapter Two however in noting how the trading trust evades historic trust law principles.

There is some debate as to whether a trustee can consensually exclude their right of indemnity, with the result that a trustee would have no right to claim out of trust assets for any liabilities incurred (in turn affecting subrogation to the trustee's indemnity).[45] In 2002 the Law Commission recommended prohibiting a trustee excluding their right of indemnity.[46] The Trusts Act does not provide any definitive answers on this as s 81 is governed by the rules at common law and equity.[47] Argument regarding the importance of the trustee's indemnity is outlined in Chapter Four when a personal remedy against the beneficiaries is sought to 'give teeth' to the trustee's indemnity. For now it is sufficient to note that the weight of commentary is in favour of the trustee being unable to consensually exclude their right indemnity out of trust assets. It is certain that a trust instrument can exclude a trustee's right to be indemnified by beneficiaries personally.[48]

C Subrogation to the Trustee's Indemnity

As liability of the trustee is personal, the creditor's primary right is against the trustee.[49] The unsecured creditor has no direct claim to trust assets.[50] If, however, because of the

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[44] *Hardoon v Belilios*, above n 36, at 124-6; Kalev Crossland "Trading Trusts", above n 12, at [46.3]. *Ron Kingham Real Estate Pty Ltd v Edgar*, above n 23, is the only trading trust case found where this has occurred.

[45] For the right of indemnity not being able to be excluded see Heath "Bringing Trading Trusts into the Company Line", above n 16, at 527-532 and McPherson, above n 1, at 144-50. For the right of indemnity being excluded see Heydon and Leeming, above n 25, at [2106] and GE Dal Pont, above n 1, at [23.155].

[46] New Zealand Law Commission, *Some Problems in the Law of Trusts* (NZLC PP48, 2002) at [28].

[47] Trusts Act, s 81(3).

[48] *Wise v perpetual Trustee Co* [1903] AC 139; *Hardoon v Belilios*, above n 36, at 127; *RWG Management Ltd v Cmr for Corporate Affairs* [1985] VR 385 at 394-5; *Ron Kingham Real Estate Pty Ltd v Edgar*, above n 23, at 442 per McPherson J; Kalev Crossland "Trading Trusts", above n 12, at [46.3].

[49] *Levin v Ikiua* (HC), above n 1, at [121]; Kalev Crossland "Trading Trusts", above n 12, at [46.4].

[50] *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319.

trustee's insolvency or bankruptcy, the creditor's claims cannot be met by the trustee personally, the trust creditor may seek subrogation to the trustee's right of indemnity.[51]

Subrogation is one instance where the law prefers the interest of the creditor over the beneficiary. The process of subrogation allows one to 'stand in the shoes of another' and utilise whatever rights that party may have.[52] Developed by the Court of Chancery, it enables a court to prevent any injustice arising by a beneficiary receiving a windfall.[53] Therefore equity regards the creditor's claim as having primacy over the beneficiary.[54] As such, a trust creditor may be able to utilise whatever right of indemnity the trustee has.

Traditionally, subrogation has been entirely derivative.[55] A creditor would not be able to be better placed than the trustee.[56] The result would be that if a trustee had impaired their right of indemnity in incurring a liability, such as through a breach of trust causing loss to trust property, the creditor's exercise of subrogation would also be impaired.[57]

This result will be changed by s 86 TA (see appendix). It provides that a creditor's subrogation claim is not automatically affected by acts such as a breach of trust. If the creditor has given value; the trust has received a benefit from the transaction between the trustee and the creditor; and the creditor has action in good faith, then the claim to subrogation remains intact to the extent of the benefit received by the trust.[58] Hence the

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51 Tucker, Poidevin and Brightwell (eds), above n 2, at [21-38].

52 *Pram Enterprises Ltd (in liq) v Mansfield* [2016] NZHC 230; *Re Johnson*, above n 10; *Vacuum Oil Co Pty Ltd v Wiltshire*, above n 50.

53 Ford "Trading Trusts and Creditor Rights", above n 12, at 19; Heath "Bringing Trading Trusts into the Company Line", above n 16, at 531; *Levin v Ikiua* (HC), above n 1, at [119].

54 *Re Johnson*, above n 10; Kalev Crossland "Trading Trusts", above n 12, at [46.4]; Heath "Bringing Trading Trusts into the Company Line", above n 16, at 531.

55 *Ex parte Edmonds*, above n 22, at 489; ALRC, *General Insolvency Inquiry*, above n 11, at 249; Kalev Crossland "Trading Trusts", above n 12, at [46.4]; NZLC, *fifth issues paper*, above n 1, at [7.22]; UK Trust Law Committee, *Rights of Creditors Against Trustees and Trust Funds*, above n 29, [2.23].

56 NZLC, *fifth issues paper*, above n 1, at [7.22]; Tucker, Poidevin and Brightwell (eds), above n 2, at 858; Jenny and Ormsby "Trading Trusts", above n 23, at 448.

57 *Levin v Ikiua* (HC), above n 1, at [126]; *Vacuum Oil Co Pty Ltd v Wiltshire*, above n 50, at 325.

58 Section 86(1) and (4).

trust creditor will no longer be completely impeded for acts outside their knowledge or control.[59]

In this respect creditors of a trading trust were often in a better possession than a traditional trust creditor because of the duties owed by a director. If a corporate trustee acted in breach of trust in incurring an obligation, then with no assets of its own, it will be extremely likely the director(s) would breach ss 135 or 136 CA (see appendix), giving the creditor a personal claim against the director(s).[60]

There is a more important flaw to indemnity and subrogation in providing a remedy to the creditor. This remedy is reliant on there being assets for the trustee to claim out of. If all trust assets have been distributed to beneficiaries, then subrogation will be fruitless.[61] This is what occurred in *Levin v Ikiua*.[62] The directors of OPC, the trading trust, conducted an 'empty shell policy' in which after discharging liabilities, all trust assets were distributed to beneficiaries every month.[63] Afterwards it was discovered that ACC, OPC's main debtor, had incidentally overpaid OPC.[64] However, because of the empty shell policy, OPC no longer had any assets and ACC had nothing to seek subrogation to.[65]

Such principles are the traditional means in which a trust creditor would seek redress. The trading trust however presents a problem in seeking to rely on such principles.

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[59] Many commentators voiced concerns about this, for instance: D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 316; Williams "Winding up Trading Trusts: Rights of Creditors and Beneficiaries", above n 11, at 277; Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 196; Hudson, above n 14, at 174.

[60] Companies Act ss 135, 16 and 301; Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 194.

[61] Jenny and Ormsby "Trading Trusts", above n 23, at 463; Taylor and Slevin, above n 23, at 1190.

[62] *Levin v Ikiua* (HC), above n 1.

[63] At [36]-[45].

[64] At [22]-[27].

[65] At [94].

II The Trading Trust – a Hybrid

This Chapter outlines the trading trust – the hybrid of trust and company law[66] – and how the trust law principles outlined in Chapter One can be inadequate for the creditor in dealing with the trading trust, particularly in regards to distributions of trust property.

The uses of trusts are constantly evolving: the value of trusts are increasing,[67] there has been a growth in professional trustee services and trust businesses are engaging in complicated and high risk transactions.[68] A paradigm example of this is the trading trust.[69] While the uses of trusts have vastly changed throughout the centuries, the legal principles regarding the position of the creditor have largely remained static.[70] Such principles cannot always be coherently applied to the way trusts are being used today.[71] The result is that, typically, trading trust creditors are more vulnerable than creditors of the traditional trust have been.

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[66] D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 301.

[67] A trading trust may be in control of millions dollars of assets: *Commissioner of Inland Revenue v Newmarket Trustees Ltd* [2012] NZCA 351.

[68] UK Trust Law Committee, *Rights of Creditors Against Trustees and Trust Funds*, above n 29, at [1.1]; Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 186; D'Angelo "The Trust: Evolution from guardian to risk-taker, and how a lagging insolvency law framework has left financers and other stakeholders in peril", above n 11, at 279-282; New Zealand Law Society, *Trust law Conference* (Wellington, New Zealand: New Zealand Law Society, 1999) at 51; D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 299.

[69] A key feature of the trading trust is that it actively engages in business as opposed to passive investment: *Levin v Ikiua* (HC), above n 1, at [97]; Taylor and Slevin, above n 23, at 1187; ALRC, *General Insolvency Inquiry*, above n 11, at 239; NZLS, *Trust Law Conference*, above n 68, at 51.

[70] Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 187; D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 305.

[71] The question of the application of these historic principles was questioned by the UK Trust Law Committee: UK Trust Law Committee, *Rights of Creditors Against Trustees and Trust Funds*, above n 29, at [1.2].

A Evolution of the Trust leading to the Trading Trust

The trust has changed radically throughout the centuries. It is an ancient creature, finding its origins in Medieval England, termed "a use", and was solely used to hold land for others.[72] This would in time transform into the trust we know today and would be used for many other purposes other than simply holding land.[73] During the 18th and 19th centuries, courts developed principles regarding the powers and obligations of the trustee, and the rights of the beneficiary.[74]

The trust in its origin was very much a passive asset holding mechanism.[75] The trust tended to hold real property or residual wealth for the benefit of others who tended to be (or perceived to be) vulnerable and in need of protection.[76] Given the intention of the trust to be used in such a passive manner, principles regarding the rights and powers of the trustee and beneficiary reflected this. For example, the default position for trusts are that assets are not be used for business as this would require putting assets at risk; a term in the trust instrument is necessary for business to be conducted with trust assets.[77]

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[72] Andrew S Butler "The Trust Concept, Classification and Interpretation" in Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 43, at 45-46; D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 301.

[73] Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 185.

[74] Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 186.

[75] NZLS, *Trust Law Conference*, above n 68, at 51; Taylor and Slevin, above n 23, at 1187; Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 187.

[76] Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 186; Hudson, above n 14, at 166-8.

[77] Tucker, Poidevin and Brightwell (eds), above n 2, at 1672; Andrew S Butler "Trustees and Beneficiaries" in Andrew S Butler (ed), *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 105 at 140; David Hayton "Trading Trusts, Trustees' Liabilties and Creditors" in David J. Hayton (ed) *The International Trust*, (3rd ed. Bristol UK: Jordans, 2011) at [7.7].

The authors of *Jacobs' Law of Trusts in Australia* stated that "the trust was not in its origin and perhaps never has been primarily a device of commerce."[78] Regardless of original intentions however, the trust has found itself employed in active profit seeking ventures in the trading trust.[79]

The trading trust came into fruition in Australasia during the 1960s and 70s.[80] The main incentive for this vehicle was to achieve a more tax effective and flexible distribution regime.[81] New Zealand is well known for its affinity for trusts.[82] It is difficult to find more than anecdotal evidence for the use of trading trusts in New Zealand, given the lack of requirement to disclose one's status as trustee;[83] such privacy is typical of trusts.[84] In 2002 the Law Commission considered the use of trading trusts to be clearly spreading.[85] If New Zealand and Australia are in anyway similar, the use of trading trusts is undoubtedly substantial.[86] Indeed in 2011 the Law Commission dedicated a substantial part of an issues paper to discussing their use.[87] The use of trading trusts is clearly here to

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78 RP Meagher and WMC Gummow, *Jacobs' Law of Trusts in Australia* (6th ed, Buttersworth, 1997) at 1xxxvii.

79 Already defined in this paper: *Levin v Ikiua* (HC), above n 1, at [97]; Taylor and Slevin, above n 23, at 1187; ALRC, *General Insolvency Inquiry*, above n 11, at 239; NZLS, *Trust Law Conference*, above n 68, at 51.

80 Robert P Austin and Ian M Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (17th ed, Chatswood, NSW: LexisNexis Buttersworths, 2018) at [20.170]; NZLC, *fifth issues paper*, above n 1, at [6.11]; D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 329; Williams "Winding up Trading Trusts: Rights of Creditors and Beneficiaries", above n 11, at 273.

81 GE Dal Pont, above n 1, at 695; *Levin v Ikiua* (HC), above n 1, at [102]; NZLC, *fifth issues paper*, above n 1, at [6.13]-[6.15]; Ford and Hardingham, above n 1, at 50; McPherson, above n 1, at 142.

82 New Zealand Law Commission, *Review of the Law of Trusts: Preferred Approach* (NZLC IP31, 2012) at [1.3]; Taylor and Slevin, above n 23, at 1187.

83 NZLC, *fifth issues paper*, above n 1, at [6.12]; Heath "Bringing Trading Trusts into the Company Line", above n 16, at 521; Trusts cannot be registered under Companies Act, s 92.

84 Blanchard J commented extrajudicially on requiring trustees to disclose the existence of trusts: Peter Blanchard "Towards a modern law of trusts" (paper presented to New Zealand Law Society trusts Conference, 2001) at 8.

85 NZLC, *Some Problems in the Law of Trusts*, above n 46, at 9.

86 The Australian Tax Office statistics for the year 2014-15 reveals there are 643,000 discretionary trusts in Australia – twice as many as 20 years ago. Just under half of these trusts are trading trusts. The total taxable income was $80 billion: https://www.acoss.org.au/ending-tax-avoidance-evasion-and-money-laundering-through-private-trusts/

87 NZLC, *fifth issues paper*, above n 1, Part 3.

stay, as there has been no suggestion of prohibiting them.[88] Therefore, it is important the law be clarified and coherent.[89]

B The Position of the Trading Trust Creditor Differing from the Traditional Trust Creditor

The rights and obligations between trustee and beneficiary are, generally, the same under a trading trust as any other trust.[90] Hence the position of the creditor of the trading trust will be largely the same as any other trust, but with additional difficulties based on the features of the trading trust.

1 All assets of the trustee are held on trust

Dealing with a trading trust may yield unexpected results in a modern commercial setting.[91] Unlike companies, which were designed to facilitate entrepreneurial activity and spread economic risk,[92] trusts exist for the benefit of beneficiaries and often subordinate creditor interests in the preservation of beneficiaries interests.[93] The results are particularly unexpected as, from all outward appearances, the trading trust looks to be an ordinary company, with control over substantial assets; none of the assets however are beneficially owned by the company.[94] Where creditors of a company have a direct claim

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[88] NZLC, *fifth issues paper*, above n 1, at [7.86].

[89]ALRC, *General Insolvency Inquiry*, above n 11, at 241.

[90] Ford and Hardingham, above n 1, at 55.

[91] D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 313.

[92] Companies Act, long title; Heath "Bringing Trading Trusts into the Company Line", above n 16, at 520; NZLC, *fifth issues paper*, above n 1, at [6.2].

[93] D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 312; Hudson, above n 14, at 164 and 166.

[94] NZLC, *fifth issues paper*, above n 1, at [7.1]; Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 190; Williams "Winding up Trading Trusts: Rights of Creditors and Beneficiaries", above n 11, at 279; Kalev Crossland "Trading Trusts", above n 12, at [46.4].

to company property, trading trust creditors do not. Meaning the creditor may be misled to the credit-worthiness of the company.[95]

Levin v Ikiua is a prime example. The Company, OPC, started out as an ordinary company but later changed to a trading trust.[96] This change was never disclosed to ACC – OPC's main debtor.[97] OPC's status as trustee and its lack of beneficial ownership in company property was only discovered once the mistaken overpayments were realised and brought forward, but no assets remained with the company.[98]

The primary recourse of the trust creditor has always been to pursue the trustee.[99] The trading trust however effectively defeats this personal claim by the employment of a limited liability company with no assets of its own.

Trust law developed with an expectation that the trustee would be responsible, so any grievance or claim against the trustee could be remedied by personal claims.[100] Trading trusts effectively negate that assumption by having an asset-less corporation as trustee.[101] Trading trusts present a new challenge in that a creditor may be entirely reliant on a trustee's right of indemnity, where previously the creditor would have ideally had their claim met by personal suit against the trustee.

The misleading nature of the trading trust in regards to the ownership of company assets and lack of creditor access to trust property explains why Professor Ford described trading trusts as a "commercial monstrosity."[102] He was concerned about creditors being unwittingly impeded by trust law with the mistaken belief that they are contracting with

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95 Ford "Trading Trusts and Creditor Rights", above n 12 , at 1.
96 *Levin*, above n 1, at [10]-[14].
97 At [16]. ACC started out as a debtor of OPC, but accidental overpayment led to OPC owing ACC approximately $400,000.
98 At [16]-[24].
99 *Levin v Ikiua* (HC), above n 1, at [121].
100 *Commissioner of Inland Revenue v Chester Trustee Services Ltd*, above n 8, at [63].
101 *Levin v Ikiua* (HC), above n 1, at [115].
102 Ford "Trading Trusts and Creditor Rights", above n 12, at 1.

an ordinary company.[103] It might be thought that a requirement to disclose one's status as trustee ought to remedy this problem. This is not the case however.

Practical difficulties aside in how disclosure would take place, enforced and the consequences of non-disclosure, there are further difficulties in seeking to provide creditor protection.[104] There is no guarantee that once the creditor is put on notice of the company's status as trustee that the creditor will make the necessary inquiries as to the company's assets or indebtedness.[105] Similarly, such a requirement will not assist the unsophisticated creditor who may not appreciate the technicalities of assets being held on trust, and may not seek a security or guarantee.[106]

In seeking to protect the creditor from the trustee's lack of personal assets, disclosure will not be sufficient. Although it is appealing as a front-end mechanism, seeking to end disputes before they start, the lack of practical effect it has in strengthening the position of the creditor makes it an unsought remedy. Ultimately, the corporate trustee will have no assets of its own, defeating the traditional personal claim of the creditor, and the creditor may still be very well be entirely reliant on the trustee's right of indemnity. The most effective means to strengthen the position of the creditor is to provide an enforceable mechanism to claw back wrongful distributions of trust property.

2 *Subrogation to trust assets and its vulnerability*

After exhausting all remedies against the trustee personally, the trading trust creditor will seek subrogation to the trustee's right of indemnity. Subrogation is a derivate right and the creditor (with exceptions)[107] will not be better placed than the trustee.[108] Subrogation

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103 Ford "Trading Trusts and Creditor Rights", above n 12, at 1.

104 NZLC, *fifth issues paper*, above n 1, at [7.8]-[7.13].

105 NZLC, *fifth issues paper*, above n 1, at [7.14].

106 NZLC, *fifth issues paper*, above n 1, at [7.15].

107 Section 86 Trusts Act provides that a creditor will not automatically by impeded by a trustee's lack of right to be indemnified.

108 *Ex parte Edmonds*, above n 22, at 489.

to trust assets is reliant on any assets being held by the trustee. Not only may the trading trust creditor be entirely reliant upon the trustees' indemnity, but this indemnity is more vulnerable than the indemnity of the traditional trustee. Trading trusts conduct active business and are employed to achieve greater protection from the claims of creditors. Therefore it is more likely that trust assets will be distributed out to beneficiaries of a trading trust than a traditional trustee might have, leaving nothing for trust creditors to claim out of.

A key feature of the trading trust is that it conducts active business,[109] contrary to the traditional assumption that trust assets are not to be put at risk.[110] Based on the risk involved in business, a corporate trustee might seek to distribute all available property to ensure the beneficiaries are catered for over creditors' claims. This readiness to distribute profits quickly is reflected in case law. In *Burns v Leda Holdings* the corporate trustee was engaged in a transaction involving real estate.[111] Afterwards, the profit of the transaction was distributed to the unit holders and the Trust was terminated. A month later, notice of assessment of stamp duty was received that was higher than expected, but no trust assets remained.[112] Similarly, in *Ron Kingham Real Estate Pty Ltd v Edgar*, the trading trust had distributed all trust property out to beneficiaries while the company had outstanding liabilities to be paid, leaving no assets for the creditor to seek subrogation to.[113] After all, *Levin* demonstrates a trading trust is able to conduct an empty shell policy (distributing all assets after discharging liabilities) honestly and without intent to prejudice creditor interests.[114]

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[109] Flannigan "The Nature and Duration of the Business Trust, above n 2, at 184-5; NZLC, *fifth issues paper*, above n 1, at [6.6]; NZLS, *Trust Law Conference*, above n 68, at 51. This is what distinguishes the trading trust from other uses of corporate trustees, such as a unit trust.

[110] Tucker, Poidevin and Brightwell (eds), above n 2, at [36-107].

[111] *Burns v Leda Holdings Pty Ltd*, above n 23, at 366.

[112] At 366.

[113] *Ron Kingham Real Estate Pty Ltd v Edgar*, above n 23, at 441.

[114] *Levin*, above n 1, at [143]-[144].

The CA recognises the risk involved in business and the desire to provide for a company's shareholders over claims of creditors.[115] Creditors of a company have priority over shareholders. As a company nears insolvency, directors may be fearful that there will be nothing left to distribute to shareholders after creditors' claims are made, and may attempt to take advantage of the separateness of the company and make distributions to shareholders, causing loss to creditors.[116] Accordingly, distributions of company property are subject to the distribution regime in the Act.[117] This seeks to ensure that shareholder interests are not preferred over creditors.[118] There is no similar regime in the CA or TA however for distributions of trust property, even though trading trusts and companies are competing side by side and are both involved in risk-taking business ventures.[119]

One of the current advantages of the trading trust is that it provides greater asset protection from the claims of creditors.[120] It seems as though nothing is safer than in the hands of the beneficiary.[121] When making distributions of trust property to beneficiaries, the perception has been that it is necessary for the creditor to prove some wrongdoing on the part of the recipient for the creditor to have a personal claim against them.[122] Whilst the entitlement of the shareholder to receive distributions is dependent on the solvency of the company, the entitlement of the beneficiary to retain distributions largely depends on the conscience of the beneficiary. In *Levin*, ACC unsuccessfully argued to be subrogated to the recipient trusts right of indemnity; instead Heath J held that for ACC to have a claim against the recipients, it would be necessary to establish a claim in equity, such as dishonest assistance or knowing receipt.[123]

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115 Neil Campbell "Distributions", above n 28, at 181.

116 NZLC, *Company Law Reform and Restatement*, above n 28, at [330].

117 Companies Act, ss 52-56.

118 Neil Campbell "Distributions", above n 28, at 180-181.

119 Waters, above n 14, at 78.

120 GE Dal Pont, above n 1, at [27.15].

121 Frederic William Maitland, "The Unincorporated Body" (Paper presented at the Eranus club), https://socialsciences.mcmaster.ca/econ/ugcm/3ll3/maitland/unincor.mai

122 *Levin v Ikiua* (HC), above n 1, at [135].

123 *Levin v Ikiua* (HC), above n 1, at [134]-[135].

This is a classic example of equity's intent to protect beneficiaries, regardless of the claims of the trust creditor. The perception is that, so long as the recipient beneficiary was honest, then regardless of creditor claims, the beneficiary is not liable for repayment. It is argued in Chapter Four that the trust creditor already has a direct claim against the recipient beneficiary based on *Diplock*, but this is untested.

Based on these factors, a trading trust creditor is more vulnerable to loss than the traditional trust creditor. Although a trading trust creditor may be entirely reliant on subrogation to the trustee's indemnity, this is more likely to be rendered valueless given the risk involved in business and the perceived ability to achieve greater asset protection by making distributions out to beneficiaries. There is an incentive to conduct an 'empty shell policy' that a traditional trust did not have. A human trustee would likely be cautious to retain assets to meet future liabilities; this is less of a concern for a limited liability company.

3 Indemnity by beneficiaries not arising for the trading trust

In the situation of a traditional trust, a trustee may have a right to be indemnified by the beneficiaries personally when trust assets are not sufficient to meet liabilities.[124] If so, a creditor may seek subrogation to this right.[125] The problem with the trading trust however is that this right will rarely arise.[126]

Although Lord Lindley in *Hardoon* stated that the plainest principles of justice require that the beneficiary who gets all the benefit of the property should also bear its burden,[127] he also stated there are limits to this principle.[128] It is *absolute* owners in equity that bear

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124 *Hardoon v Belilios*, above n 36.

125 *Ron Kingham Real Estate Pty Ltd v Edgar*, above n 23, at 443; Ford "Trading Trusts and Creditor Rights", above n 12, at 19.

126 Kalev Crossland "Trading Trusts", above n 12, at [46.3].

127 At 123.

128 At 127.

the burdens incidental to its ownership.[129] The trading trust will inevitably involve discretionary beneficiaries as this is how the tax advantages of the trading trust are employed.[130] The beneficiaries will wish to avoid having an absolute interest in trust assets for the purpose of tax liability, and discretionary beneficiaries do not have a proprietary interest in trust assets being distributed.[131] If a discretionary beneficiary could be sought for indemnification, they would be liable for something that was never theirs as they merely have the right to be considered.[132] Furthermore, they would potentially be liable for trust debts despite not having the power to terminate the trust.[133]

On top of these conceptual restraints, there is also the difficulty that a trust instrument can exclude a trustee's right to be indemnified by beneficiaries. *Hardoon* stated that there could be trusts that limit a trustee's ability to be indemnified by beneficiaries.[134] Unlike the trustee's indemnity out of trust assets, where there is debate if this could be excluded by a trust instrument,[135] it is clear that a right of indemnity by beneficiaries can be excluded.[136]

As the trading trust inevitably involves discretionary beneficiaries, and a right to be indemnified by beneficiaries can easily be excluded, it is extremely unlikely a creditor could ever seek subrogation to this right. This is not unusual as a discretionary trust is the

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[129] At 124.

[130] *Levin v Ikiua* (HC), above n 1, at [100]; Ford "Trading Trusts and Creditor Rights", above n 12, at 1; Ford and Hardingham, above n 1, at 54; McPherson, above n 1, at 142.

[131] *Gartside v Inland Revenue Commissioners* [1968] AC 553 (HL).

[132] Butler (ed), above n 23, at 51 and 445.

[133] If beneficiaries are of full capacity and absolutely entitled then they can terminate the trust: Saunders v Vautier (1841) 4 Beav 115.

[134] At 127.

[135] For the right of indemnity not being able to be excluded see Heath "Bringing Trading Trusts into the Company Line", above n 16, at 527-532 and McPherson, above n 1, at 144-50. For the right of indemnity being excluded see Heydon and Leeming, above n 25, at [2106] and GE Dal Pont, above n 1, at [23.155].

[136] *Wise v perpetual Trustee Co*, above n 48; *Hardoon v Belilios*, above n 36, at 127; *RWG Management Ltd v Cmr for Corporate Affairs* [1985] VR 385 at 394-5; *Ron Kingham Real Estate Pty Ltd v Edgar*, above n 23, at 442 per McPherson J; Kalev Crossland "Trading Trusts", above n 12, at [46.3].

most popular form of trust in New Zealand,[137] but when taken with the above listed factors, it poses extra problems for the trading trust creditor.

C Trust Principles Remaining Static

To summarise, the principles regarding the position of the trust creditor have remained largely static throughout the centuries, while the use of trusts have fundamentally changed.[138] The trading trust nullifies the trustee's personal liability by using an asset-less company; is prone to distributing trust assets as quickly as possible, in turn affecting the creditors remedy of subrogation; and would rarely be entitled to be indemnified by beneficiaries. All of this comes to a head when all trust assets have been distributed to beneficiaries. The creditor's inability to claw-back distributions of trust property is particularly relevant for two reasons: (1) the trading trust is engaged in active business as opposed to passive investment or holdings;[139] and (2) the trading trust is formed by investors making a deliberate choice of employing such a vehicle, and then taking the position of beneficiary.[140]

1 The trading trust conducting active business

The trading trust conducting active business distinguishes it from other types of trust.[141] Risk is inherent in business.[142] Much of trust law however is anchored in principles which exhibit a protective bias to beneficiaries, while displaying indifference to the interests of

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137 SuperLife "Family Trusts" https://www.superlife.co.nz/resources/articles-guides/family-trusts

138 D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 299.

139 ALRC, *General Insolvency Inquiry*, above n 11, at 239; NZLS, *Trust Law Conference*, above n 68, at 51; *Levin v Ikiua* (HC), above n 1, at [97].

140 Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 188; Flannigan "The Nature and Duration of the Business Trust, above n 2, at 184-5; *Berry v McCourt* (1965) 204 NE 2d 235 at 240.

140 D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 301.

141 Jenny and Ormsby "Trading Trusts", above n 23, at 416; NZLC, *fifth issues paper*, above n 1, at [6.6].

142 John Farrar "The Duties of Care of Directors" in John H. Farrar and Susan Watson (eds) *Company and Securities Law in New Zealand* (2nd ed, Wellington, NZ: Thomson Reuters, 2013) 415 at 415.

outsiders.[143] This is exhibited in rules regarding distributions. Historically, where a beneficiary has been overpaid, the trustee can deduct this from future payments due or likely to fall due, but if no such payments are made, then the beneficiary cannot be called upon to repay the overpayment.[144] The basis of this rule is that it would be unjust or inequitable to expect a beneficiary to be able to repay such amounts.[145]

This is in stark contrast the Companies Act. The Act acknowledges the risk in business but also the benefits it brings to the economy.[146] Accordingly the Act seeks to spread economic risk and provide for the protection of outsiders from abuses of management powers.[147] One example of this is the distribution regime which balances the rights and interest between creditors and shareholders. There is no such balancing act for the rights and interests of the trust creditor however – the tilt is very much towards the favour of the beneficiaries.[148]

The trading trust engages in the exact kind of activity that would have received the disapproval of the early chancellors.[149] A trust existing in such a manner would not have been expected when the principles of trust law were being formulated.[150] This is a key functional difference that distinguishes the trading trust from the traditional trust and is

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143 D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 312; Hudson, above n 14, at 164 and 166; UK Trust Law Committee, *Rights of Creditors Against Trustees and Trust Funds*, above n 29, at [1.5]; Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 196; Waters, above n 14, at 77-8.

144 *Downes v Bullock* (1858) 25 Beav 54; 53 ER 556 at 62; 559; *Halsbury's Laws of Australia* (reissue, 1995) vol 27 Trusts at [430-4200].

145 *Burns v Leda Holdings Pty Ltd*, above n 23, at 379.

146 Companies Act, long title.

147 Companies Act, long title.

148 UK Trust Law Committee, *Rights of Creditors Against Trustees and Trust Funds*, above n 29, at [1.5]; Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 186; D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 307.

148 D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, 299 at 302.

149 D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, 299 at 302.

150 Taylor and Slevin, above n 23, at 1188.

more analogous to the usual conduct of a company.[151] As such, a creditor of the trading trust ought to have similar means of protection as the creditor of the company has.

2 The genesis of the trading trust compared to the traditional trust

The genesis of the trading trust usually differs from the traditional trust. The traditional trust is formed by beneficiaries taking their interest by gift.[152] A key feature of the trading trust is that business is conducted by a company acting as trustee. Companies do not form by themselves. The trading trust is formed by investors consensually looking to employ the trust as their chosen business vehicle;[153] the relationship is closer to contractual in nature.[154] The genesis of the trading trust demonstrates a departure from the traditional trust. It is more convincing to protect beneficiaries from being personally liable to repay distributions of trust property when they had inherited a gratuitous gift; it is less convincing to protect trading trust beneficiaries who simply chose the trust as a business vehicle.

D'Angelo argues that exploitation of trusts and trust law is implicit in the use of trading trusts.[155] The trading trust represents investors making a deliberate choice of a vehicle which avoids restrictions imposed on other companies, namely a distribution regime.[156] Trading trusts not being subject to such restrictions on distributing trust property lacks a foundation in both policy and principle.

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151 H.B. Chermside, "Modem Status of the Massachusetts or Business Trust" A.L.R. (3d) 704 (1978) at 720.
152 Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 188; Flannigan "The Nature and Duration of the Business Trust, above n 2, at 184-6.
153 *Berry v McCourt,* above n 140, at 240.
154 Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 188.
155 D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 303.
156 D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, 299 at 303.

D The Failure of Trust Law in Dealing with the Insolvent Trading Trust

Reliance on historic trust law principles exhibits fundamental flaws in dealing with the trading trust with no assets. Subrogation was a remedy designed to avoid the injustice of a beneficiary receiving a windfall.[157] Equity therefore regards the interests of the creditor as having primacy over the beneficiaries.[158] It has also been said that the plainest principles of justice require a beneficiary who receives all of the benefit of the property should also bear its burden.[159] Whilst these principles are appealing in the abstract, reliance on these principles do not assist the creditor of the insolvent trading trust.

This is because the creditor is reliant on there being assets to claim out of: if all the assets have been distributed then the beneficiary remains protected. The beneficiary is protected by centuries old law which does not adequately cater for the risks involved in business. This is regardless of the fact that trading trusts are formed by investors seeking to avoid restrictions in the Companies Act whilst engaging in risk taking business ventures.

Heath J argues the likely inability for a trustee to ever consensually exclude their right of indemnity out of trust assets is a key reason why trading trusts do not pose a problem.[160] He stated this in an article written after *Levin v Ikiua*, a case he decided. Reliance on the trustee's indemnity is strengthened by s 81 TA as the creditor can still seek subrogation even if the trustee is not entitled to be indemnified (such as through breach of trust), but it is still vulnerable to being rendered valueless by distributions. OPC's indemnity could not assist the creditors in *Levin* as there were no longer any assets to claim out of.[161] The creditor was not impeded by an impaired indemnity based on dishonest acts of the trustee,

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157 *Pram Enterprises Ltd (in liq) v Mansfield*, above n 52, at [55]; Heath "Bringing Trading Trusts into the Company Line", above n 16, at 531; Ford "Trading Trusts and Creditor Rights", above n 12, at 15; *Levin v Ikiua* (HC), above n 1, at [119].

158 Kalev Crossland "Trading Trusts", above n 12 , [46.4]; *Re Johnson*, above n 10; Heath "Bringing Trading Trusts into the Company Line", above n 16, at 531; *Levin v Ikiua* (HC), above n 1, at [119].

159 *Hardoon v Belilios*, above n 36, at 123 and 124.

160 Heath "Bringing Trading Trusts into the Company Line", above n 16, at 527-533.

161 At [94].

but by distributions to beneficiaries. *Levin* highlights perfectly the inadequacy in dealing with the insolvent trading trust with trust law principles.

Once personal remedies against the trustee have been exhausted, and subrogation cannot remedy the creditor's claims, the creditor might wish to seek recourse from the recipient beneficiary. The creditor faces several boundaries however. The creditor contracts with the trustee personally, not the beneficiary. As there is no direct relationship between the creditor and beneficiary, the beneficiary is not ordinarily liable for trust debts.[162]

This is by no means out of the ordinary in a commercial setting. A creditor who engages with a company contracts with that company – a distinct legal entity, separate from those who hold shares in it.[163] Both the beneficiary and the shareholder may receive distributions in which a creditor has a stake in. Where the situation of a beneficiary and shareholder differ is the shareholder's receiving of distributions is governed by the distribution regime in the Act,[164] but there is no comparable regime in New Zealand's trust law.

Courts of equity may have been accustomed to dealing with a trustee's bankruptcy, but they never developed a law of insolvency for trusts.[165] D'Angelo notes several factors where trust law suffers from fundamental defects in regulating commercial entities, particularly in insolvency:[166]

a) it is not comprehensive in the commercial context because it was never developed to deal with commercial enterprises;
b) it is not readily accessible to the non-expert;
c) being a creature of equity, its operation is largely on the basis on conscience and might produce unexpected results in a modern commercial setting.

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162 *Re Enhill* (1983) 7 ACLR 8.
163 Companies Act, s 15.
164 Companies Act ss 4, 52 and 56.
165 D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 299.
166 at 314.

A chief concern of this dissertation are trusts being a creature of equity. Where company law will always prefer the interests of the creditor over the shareholder (absent relevant disentitling conduct), trust law often prefers the interest of the beneficiary and relies on conscience for action (e.g. for a claim of dishonest assistance or knowing receipt).[167]

Take a distribution of property. Where a shareholder receives a distribution which fails the solvency test, the shareholder will be personally liable to repay this (subject to defences).[168] Directors may also be liable to cover any shortfall from the shareholder.[169] The Act bring first attention to the shareholder however. No proof of fault or dishonesty is required.[170] Failure of the solvency test gives the creditor a prima facie claim against the shareholder.[171] It is only logical that the recipient of a wrongful distribution be liable for its repayment as they were not entitled to it. This is in stark contrast to the position in trust law where the perception has been it is necessary for the creditor to establish wrongdoing on the part of the recipient.[172] This is challenged in Chapter Four.

E Conclusion

The trading trust is a radical departure from the traditional trust in which principles regarding the rights of the beneficiary, trustee and creditor were formulated with regard to. Reliance on these principles are fruitless for the creditor who has been prejudiced by a distribution by a trading trust to beneficiaries, which is more likely to occur with the trading trust.

Reliance on trust law principles is not the only option for the trading trust creditor. Whilst acting as trustee, the company is still subject to the CA.[173] The Act is able to provide a

[167] at 313.
[168] Companies Act, ss 4, 52 and 56.
[169] Companies Act, s 56(3) and (4).
[170] Neil Campbell "Distributions", above n 28, at 198.
[171] Neil Campbell "Distributions", above n 28, at 198.
[172] *Levin v Ikiua* (HC), above n 1, at [134]-[135].
[173] Heath "Bringing Trading Trusts into the Company Line", above n 16, at 537.

reasonable means of creditor protection through provisions regarding voidable preferences and directors duties. As will be seen however, the Act is still limited in its scope as the distribution regime is not applicable to trust property.

III Application of the Companies Act

This Chapter outlines provisions in the Act designed for creditor protection and how these provisions apply to the trading trust. The Act seeks to utilise the effectiveness of the company for business while protecting creditors (and shareholders) from potential abuses of management powers.[174] The reach of the Act is limited however in that key sections designed for creditor protection do not apply to the trading trust, particularly the distribution regime.[175] There is no reason why creditors of the trading trust should be exposed to more risk than the creditor of the traditional company in not being protected by restrictions of distributions.

A The Company and the Risk of Limited Liability

The distinguishing feature of the company is that it is a distinct legal entity, separate from those who hold shares in it.[176] Ordinarily, liability of the shareholders is limited to the amount invested in the company.[177] The risk posed to creditors by dealing with this entity is obvious: its members might try to hide behind the corporate veil, taking undue risks and cause loss to third parties, all the while being protected by the separateness of the company.[178] Accordingly, the Act provides several means of protection for creditors (only the most relevant for the creditors of the trading trust will be discussed).

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[174] Companies Act, long title.

[175] *Levin v Ikiua* (HC), above n 1, at [108]; Companies Act, ss 4, 52 and 56.

[176] Companies Act s 15; *Salomon v Salomon and Co Ltd* [1897] AC 22 (HL).

[177] Companies Act, s 97; Neil Campbell "Distributions", above n 28, at 39; Susan Watson "Corporate Liability for Criminal and Civil Wrongs" in John H. Farrar and Susan Watson (ed), *Company and Securities Law in New Zealand* (2nd ed, Wellington, NZ: Thomson Reuters, 2013) 165 at 181.

[178] Susan Watson "Duties of Directors: Duties of Loyalty in Farrar and Watson" in John H. Farrar and Susan Watson (eds) *Company and Securities Law in New Zealand* (2nd ed, Wellington, NZ: Thomson Reuters, 2013) 359 at 360.

B Dealings with Third Parties

In contracting with a company there is a chance that the person or company is acting outside of their permitted authority in the transaction. A creditor is not imposed with knowledge of a company's inner workings however.[179] Section 18 CA protects third parties dealing with a company when a company or a person did not have authority to enter the transaction (amongst other vitiating factors),[180] unless the person knew or ought to have known of the contracting party's lack of authority. Section 18 acts as a form of statutory estoppel, protecting those who deal with the company.[181]

The position of the trust creditor has been strengthened following the Trusts Act 2019, but the trust creditor is still in a weaker position than those dealing with an ordinary company and a party acting outside of their authority. The new Trusts Act does however still show a move to strengthen the position of the trust creditor.

Now the creditor seeking subrogation will not always be impeded if the trustee has impaired their right of indemnity. A trustee acting outside of their authority is one way in which a trustee might impair their right of indemnity.[182] Previously, this would have impaired the creditor's subrogation claim.[183] Now s 86 TA assists the creditor in situations where the trustee is not entitled to be fully indemnified. The creditor still has an indirect claim to trust property if: the creditor has given value; the trust has received a benefit from the transaction between the trustee and the creditor; and the creditor has

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[179] *Royal British Bank v Turquand* (1856) 6 E & B 327; 19 ER 886.
[180] Such as the Act of company's constitution not being complied with.
[181] Susan Watson "Legal Relationships with Third Parties" in John H. Farrar and Susan Watson (eds), *Company and Securities Law in New Zealand* (2nd ed, Wellington, NZ: Thomson Reuters, 2013) 125 at 135. The company is also precluded from asserting against the third party that the Act or constitution has not been complied with: s 18, Companies Act.
[182] NZLC, *fifth issues paper*, above n 1, at [7.24]; Jenny and Ormsby "Trading Trusts", above n 23, at 449; Kalev Crossland "Trading Trusts", above n 12, at [46.3].
[183] *Ex parte Edmonds*, above n 22, at 489.

acted in good faith.[184] Then the creditor still has a claim to subrogation to the trustee's indemnity, to the extent that the trust has benefitted.[185]

For decades commentators have criticised the position in trust law where a creditor's access to trust assets would be impeded by acts completely outside of their knowledge or control (such as a previous breach of trust causing loss to trust property).[186] Although the position of the trust creditor has been strengthened, it is still weaker than the position of the ordinary company's creditor. It is not necessary for the company's creditor to have given value or benefitted the company, for the company to be estopped from asserting that the party did not have authority; nor is their claim limited to the extent that the company has benefitted.[187]

This differing treatment of outsiders between trusts and companies has not been of monumental importance for trading trusts because, as noted, an asset-less company incurring an obligation in which it has no means of meeting will almost certainly result in a breach of directors duties.[188] However, it is still worth noting as this change demonstrates a desire to strengthen the position of the trust creditor.

C The Voidable Preference Regime

The regime[189] reflects the reality that when a company is placed into formal liquidation, it has often been insolvent for some time.[190] The regime then seeks to prevent some

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184 Section 86.

185 Section 86(4).

186 Williams "Winding up Trading Trusts: Rights of Creditors and Beneficiaries", above n 11, at 277; Ford "Trading Trusts and Creditor Rights", above n 12, at 2; Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 196; Hudson, above n 14, at 174; D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 308.

187 The Company can is also precluded from asserting against the third party that the Act or constitution has not been complied with: Companies Act, s 18.

188 Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 194; *Owens v Shaw* [2016] NZHC 1400. Most likely ss 135 or 135 Companies Act.

189 Companies Act, ss 292-296.

creditors from receiving an unequal share of their debt and to ensure that all unsecured creditors are treated equally.[191] Contrary to some previous judicial assumptions, the regime does not seek to maximise the pool of assets available for distribution in a company's liquidation;[192] rather the regime seeks to ensure that unsecured creditors share pari passu in a company's liquidation and that a creditor does not receive an inappropriate advantage.[193] Accordingly, certain payments may be declared void and recovered from the recipient. Application of the voidable preference regime to trading trusts has received little judicial consideration in New Zealand.[194]

The regime has a very limited application to trading trusts in that the regime requires the relevant payment be towards the satisfaction of a debt.[195] The trading trust however often seeks to distribute money to beneficiaries. The relationship between the trustee and beneficiary is not inherently a creditor/debtor relationship however.[196] Therefore the regime will have only a minor application to trading trusts.

Section 298 CA on transactions for inadequate or excessive consideration (see appendix) has been held not apply to trust property.[197] This section can only apply to transactions where the directors are bound to consider the best interests of the company and obtain fair value in return for the disposition – this does not apply when a director of a corporate trustee is seeking to distribute trading profits to beneficiaries.[198]

190 Murray Tingey and Nick Moffat "Antecedent Transactions" in Heath and Whale (eds), *Insolvency Law in New Zealand*, above n 12, at [24.1].
191 Murray Tingey and Nick Moffat "Antecedent Transactions", above n 190, at [24.1].
192 *Market Square Trust v Levin* (2005) NZCLC 264, 935 and *Bank of New Zealand v Coyle* (1999) 8 NZLCLC 262,100 were overturned in *Levin v Market Square Trust* [2007] 3 NZLR 591.
193 *Allied Concrete v Meltzer* [2016] 1 NZLR 141 at [1].
194 It appears *Levin v Ikiua* is the only case in New Zealand to consider this.
195 Companies Act, s 292(2)(b).
196 *Burns v Leda Holdings Pty Ltd*, above n 23, at 381-385.
197 *Levin v Ikiua* (HC), above n 1, at [85]-[86] affirmed in *Levin v Ikiua* [2010] NZCA 509 at [54].
198 *Levin v Ikiua* (CA), above n 197, at [54].

However, Heath J writing extrajudicially noted that s 292(3)(e) regarding insolvent transactions (see appendix) applies to money held on trust by a company.[199] This is based on the reasoning of the Court of Appeal in *Anzani*,[200] affirmed by the Supreme Court in *Mcintosh v Fisk*.[201] Section 292(3) defines a "transaction" for the purposes of a voidable transaction. Whilst para (a) refers to "conveying or transferring the *company's* property", and (b) refers to "creating a charge of the *company's* property", para (e) simply refers to the paying of money".[202] Therefore it was a simple matter of statutory interpretation that this paragraph was not restricted to the paying of the company's money.[203] This was also supported by policy reasons. If a company uses stolen money or money held on trust to pay a debt, then it is hard to see why the recipient creditor should be immune to the claw-back provisions simply because of the money's source.[204] Payment by a company towards the satisfaction of a debt, whether of the company's money or not, is a transaction for the purpose of s 292.[205] Therefore, payment by a trading trust of trust property towards the payment of a debt could be declared void.[206]

Heath J believes this to be another key reason why trading trusts do not pose a problem.[207] Whilst it is true that payments by a trading trust when preferring one creditor over another will be caught by this section, that is the exact limit of this section – it is limited to the preference of *creditors*. It is difficult to see s 292(3)(e) as a meaningful answer to the risk of trading trusts after *Levin*, the case Heath J decided, where this section was not applicable as the recipient beneficiaries were not creditors of OPC.[208] Instead, the beneficiaries remained protected against the claims of ACC.

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[199] Heath "Bringing Trading Trusts into the Company Line", above n 16, at 536.
[200] *Anzani Investment Ltd v Official Assignee*, above n 17.
[201] *McIntosh v Fisk*, above n 17.
[202] Emphasis added.
[203] *McIntosh v Fisk*, above n 17, at [56].
[204] At [57].
[205] At [59].
[206] Heath "Bringing Trading Trusts into the Company Line", above n 16, at 539.
[207] Heath "Bringing Trading Trusts into the Company Line", above n 16, at 533-7.
[208] For this reason the liquidators brought their claims under s 298 Companies Act.

The problem of trading trusts have never been an ability to prefer one creditor over another – it is the extra protection afforded to beneficiaries compared to other residual owners, such as shareholders, that causes concern. A company holding all property on trust is able to circumvent provisions, such as s 298, enabling recovery of certain payments. Whilst it is clearly possible for a beneficiary to double as a creditor,[209] in which case an insolvent payment could be recoverable; the trustee/beneficiary relationship is not inherently a creditor/debtor relationship however.[210] The trading trust will often make distributions to beneficiaries who are not creditors of the company and the regime will not apply. This is one instance where provisions in the Act designed for creditor protection lack general application to trading trusts, making the creditor more vulnerable than an ordinary company's creditor.

D Duties of a Director

There are several duties owed by a director in the CA (and common law)[211] to the company. These duties are by far the Act's most meaningful answers to the risks of trading trusts. The duties owed in Part 8 CA apply regardless of the company's status as a trustee. Whilst the duties of a director largely assist the trading trust director, there are still gaps. Such a remedy is (of course) duty based and solely targets the director(s) in question. Distributions which prejudice creditors do not necessitate a breach of duty and any possible breach does not provide recourse to the non-director recipients.

Whilst these duties are owed to the company rather than to a particular creditor,[212] some duties are more likely to be enforced by creditors in a company's liquidation. In a company's insolvency the most relevant statutory duties are going to be ss 131, 135, 136 and 137 (see appendix).

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[209] For instance, *Octavo Investment Pty Ltd v Knight* (1979) 144 CLR 360 (HCA) the beneficiaries had lent the trading trust funds.

[210] *Burns v Leda Holdings Pty Ltd*, above n 23, at 381-385.

[211] *Benton v Priore* [2003] 1 NZLR 564.

[212] *Ulsterman Holdings Ltd (in liq) v Walls* [2017] NZHC 3040 at [30].

Not every trading trust's insolvency will leave a creditor with only a meaningless claim to a trustee's indemnity. Many cases will also furnish a breach of directors duties. For instance, *Owens v Shaw*.[213] The Shaws' operated a business as glaziers and manufactures of aluminium joinery as a trust.[214] While the majority of suppliers were willing to deal directly with the trustees, a major supplier, Viridian, had a policy of only contracting with a company.[215] As such the Shaws' incorporated Aluminium Plus Wellington (APW) to deal with Viridian (and anyone else who wished to contract with the Company).[216] The Company did not have a bank account; rather, when Viridian supplied products to APW, payment was made by cheque from the I&A Shaw Family Trust.[217] The Company eventually defaulted on a $61,000 invoice after discharging the Trust's obligation to pay the Viridian invoices.[218] The liquidators alleged several breach of duties.[219]

In the matter of s 135 on reckless trading, the Court noted the test is one of solvency and not liquidity, adopting the approach of the Court of Appeal in *Yan v Mainzeal Property Construction Ltd (in rec and liq)*,[220] taking a commercially realistic approach of the Company's financial position.[221] Although APW did not have a bank account and was entirely reliant on funds from the Trust, incurring obligations was not in breach of s 135 as the APW had a secure method of payment.[222] As stated in *Yan*, "… it is common for companies to require support from related companies in a group or from shareholders".[223] However, the position instantly changed when the Company discharged the Trust from

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[213] *Owens v Shaw*, above n 198. This is not technically a trading trust case (as I have defined it) as the Company did not act as trustee. However, the contract and supply agreement between the Company and the Trust had the same effect as a right of indemnity would. Therefore the case serves as meaningful discussion.

[214] At [1].

[215] At [2] and [3].

[216] At [4] and [5].

[217] At [7]-[10].

[218] At [12] and [30].

[219] At [17] alleged breaches of duty were ss 135, 136, 137 .

[220] [2014] NZCA 190 at [60].

[221] At [32] and [33].

[222] At [37].

[223] *Yan v Mainzeal Property Construction Ltd (in rec and liq)* [2014] 190 at [86].

the obligation to meet company liabilities.[224] Once the directors of APW released the Trust from the payment obligations, APW was exposed to an obvious risk of loss with no assets or income to meet liabilities.[225] This was a breach of s 135.[226] Similarly, when the directors released the Trust as sole funders of Viridian purchases, the directors were plainly negligent and breached s 137.[227] Accordingly, compensation was awarded under s 301,[228] adopting the approaches of *Mason v Lewis*[229] and *Madsen-Reis v Petera*.[230]

Or *NZ Natural Therapy Ltd (in liq) v Little*,[231] which is more apt in the context of distributions. The Company was part of a network of entities and trusts.[232] Mr Little treated the entitles as existing for the benefit of himself and his family, and accordingly, transferred funds to himself as he thought convenient.[233] Mr Little shuttled money to himself without regard to the interests of the Company or its creditors while the Company was insolvent.[234] In putting his own and his family's interests ahead of the Company's, he plainly breached s 131.[235] Along similar reasoning he also breached ss 133, 135, 135 and 137.[236]

These cases serve as a useful reminder. It is possible for an asset-less company to operate effectively as trustee, without harming creditor interests, or directors breaching their duties. However, when the directors take a course of action that will cause obvious loss to the company's creditors, it is plain a breach of duties will result.[237] Also, it is not possible

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224 At [43].
225 At [43].
226 At [44].
227 At [57].
228 At [66].
229 *Mason v Lewis* [2006] 3 NZLR 225 (CA).
230 *Madsen-Reis v Petera* [2015] NZHC 538.
231 *NZ Natural Therapy Ltd (in liq) v Little*, above n 16.
232 At [2].
233 At [2].
234 At [71].
235 At [72].
236 At [76], [83], [86], [88].
237 *Owens v Shaw*, above n 198 at [43]-[44]. See also *Lakeside Ventures 2010 Ltd (in liq) v Burrow* [2014] NZHC 1048.

to exempt a director from the duties owed to the company – putting personal interests first which detrimentally affect the company will result in a breach of duty.[238]

However, not every case will be so simple. It may be the case the directors are not worthwhile suing. Or more importantly, a distribution of trust property, prejudicing creditor interests, may not result in a breach of duty in the first place. In *Levin v Ikiua* OPC Management Rehab (OPC) provided services for ACC while acting as trustee for the directors family trusts.[239] Over the course of dealings, OPC incidentally overcharged ACC by nearly $400,000.[240] By the time this was discovered, OPC had already distributed these funds to the recipient family trusts, leaving no assets for ACC to claim against.[241] Amongst other claims, the liquidators claimed a breach of directors duties by Mr Ikiua and Mr Apa, alleging their 'empty shell policy' of after discharging liabilities to distribute all available funds to the recipient trusts every month was an operation designed to defeat creditor interests.[242]

Heath J found against that claim, holding that the directors conducted the business honestly and in good faith, except for one distribution of $8,000 which was made after the directors had notice of the overpayments.[243] The directors had been reasonably prudent in discharging the liabilities. Without knowledge of the overpayments and in meeting the standard care and skill expected, they had not breached their duties owed by making such distributions.[244]

Depending on the factual situation, creditors of a trading trust may not be able to rely on directors duties in satisfying their claims. The distribution of such funds may not have breached any duties owed to the company. Even if a breach is found, the worth of finding this breach is dependent on the directors credit-worthiness. Relying on a breach of duties

238 *NZ Natural Therapy Ltd (in liq) v Little*, above n 16, at [71].
239 *Levin v Ikiua*, above n 1, at [4]-[17].
240 At [73].
241 At [28].
242 At [143].
243 At [143]-[146].
244 At [143]-[145].

is not necessary for the creditor of an ordinary company who has been prejudiced by a distribution however. The distribution regime posits another potential defendant for the creditor who has been prejudiced by distributions.

E The Distribution Regime

Distributions of company property is governed by the Act (see appendix: s 52 CA). Creditors of a company might seek recourse against shareholders who received distributions of company property.[245] This is an attractive remedy for the creditor as a right of recovery (subject to defences) simply depends on proof that the company failed the solvency test when the distribution is made.[246] Trading trusts not being subject to any similar regime is a flaw in the regulation of trading trusts.

The authors of *Company Law in New Zealand* list three reasons to regulate distributions:[247]

(1) to protect creditors from the abuse of limited liability;
(2) to ensure shareholders are treated equally;
(3) to control the risk of directors using their powers of distributions.

The framers of the Act saw the solvency test as a crucial means of creditor protection, especially when a company nears insolvency, where there might be extra incentive to exploit the company's limited liability.[248] When a company nears insolvency, there might be incentive to make distributions to its own members before the creditors make their claims.[249] As creditors have priority over shareholders, the board may be fearful that there will be nothing left for the company's own members once creditor claims are made, and

245 Companies Act, s 56.
246 Neil Campbell "Distributions", above n 28, at 198.
247 Neil Campbell "Distributions", above n 28, at 180.
248 NZLC, *Company Law Reform and Restatement*, above n 28, at [330].
249 NZLC, *Company Law Reform and Restatement*, above n 28, at [330]; Neil Campbell "Distributions", above n 28, at 181.

attempt to divert the company's property to the residuary claimants, attempting to nullify the claims of creditors to company property.[250]

The Act provides for the recovery of distributions of company property that failed to solvency test. Section 56 (see appendix) provides the shareholder with a threefold defence, preventing recovery if: the distribution was received in good faith and without knowledge of the company's failure of the solvency test; the shareholder has altered their position in reliance of the validity of the distribution; and it would be unfair to requirement payment in part or in full.[251] Directors will also be liable to cover any shortfall from the shareholders if they have been in fault in making the distribution.[252]

Section 56 draws first attention to the shareholder however.[253] The distribution regime is an attractive remedy for the creditor as there is no need no prove any fault on the part of the board in making the distribution; recovery simply depends on the company not meeting the solvency test at the time of making the distribution.[254] Matters of solvency may be difficult to prove in large scale entities, but at the very least the solvency test is not reliant on making findings of fact of a director's state of mind (as is necessary for many duties owed in Part 8 CA). It is only logical that the recipients of a distribution made at a time when the company was not solvent should be liable repay those amounts.

Whilst the distribution regime is a key pillar in the Act in providing for creditor protection, it is nullified by the use of the trading trust. Where a company does not have beneficial ownership of property, it is not subject to the distribution regime.[255] A key feature of the trading trust is that all of the company's assets are held on trust.[256] Therefore the trading trust is able to circumvent the regime and seemingly make distributions to beneficiaries, regardless of creditor claims to the trustee. By

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[250] Neil Campbell "Distributions", above n 28, at 181.

[251] Companies Act, s 56(1).

[252] Neil Campbell "Distributions", above n 28, at 198.

[253] Companies Act, s 56(3); Neil Campbell "Distributions", above n 28, at 198.

[254] Companies Act, s 56(3); Neil Campbell "Distributions", above n 28, at 198.

[255] *Levin v Ikiua* (HC), above n 1, [108].

[256] NZLC, *fifth issues paper*, above n 1, at [6.7]; Ford and Hardingham, above n 1, at 50.

circumventing the distribution regime the trading trust removes a potential defendant for the creditor to remedy their claim. It is only when directors are at fault that a trading trust creditor will be provided with a remedy following a distribution.

If a director authorises a distribution when loss to a creditor is likely to result, then there will likely be a breach of duty.[257] If on the other hand, a director carefully considers the company's financial position and makes a decision on reasonable grounds that creditors will not be prejudiced by a distribution, then they will not be personally liable for such a distribution.[258] This line of authority comes from *Nicholson v Permakraft*; such a case involving dividends to shareholders would today however be dealt with under the distribution regime.[259] The drafters of the 1993 Act intended for recovery of distributions to simply depend on a company's solvency, not fault; and to provide a right of recovery against the recipients. The trading trust creditor on the other hand, while dealing with a company, is not protected by the distribution regime; the creditor is reliant on one set of defendants (directors) and finding a breach of duty by a director, rather than being able to rely on simply proving a company's insolvency in making a distribution to have a right of recovery.

Nicholson v Permakraft highlights this point of difference well. *Nicholson* involved distributions to shareholders in circumstances where the Company had outstanding debts, thereby causing loss to the creditors.[260] The actions of the directors however were held to be reasonable and the directors were therefore not personally liable to the creditors.[261] *Nicholson* was decided before the 1993 Act, but the 1993 Act is consistent with the case (except insofar as the case suggests creditors are owed and can enforce duties directly).[262] The Company clearly would have failed the solvency test if one existed at the time, as the

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257 *Levin v Ikiua* (HC), above n 1, at [142]; *Nicholson v Permakraft* [1985] 1 NZLR 242 at 250 per Cooke J.
258 Heath "Bringing Trading Trusts into the Company Line", above n 16, at 539.
259 *Levin v Ikiua* (HC), above n 1, at [141].
260 *Nicholson v Permakraft*, above n 257, at 242.
261 At 253.
262 NZLC, *Company Law Reform and Restatement*, above n 28, at [220].

Company could not pay its due debts after the distribution,[263] yet the directors were not personally liable for the creditors loss.[264] This case highlights the ability for creditors to suffer loss by way of distributions, but the directors will not necessarily be personally liable for this.

The trading trust not being subject to any distribution regime and the creditor not having an effective means of recovery is problematic. The trading trust is a corporate trustee with limited liability, engaging in risk-taking business activity.[265] Taking the points from *Company Law in New Zealand* above, creditors of the trading trust are just as vulnerable to abuses of management powers and their interests being prejudiced by distributions as an ordinary company's creditor is. The Act sought to curtail this by imposing a distribution regime, but it does not assist the trading trust creditor. The label of 'beneficiary' should not cloud the interests of the creditor who may be vulnerable to distributions.

The result is that there are two vehicles which are functionally and economically similar, but the trading trust is subject to significantly less restrictions on distributions, leaving the creditor more vulnerable.[266] This is not surprising given the historic focus of trust law being on the relationship between trustee and beneficiary, meaning creditor interests would sometimes be neglected.[267] Such lack of protection is however unfounded in a modern commercial setting, where the law seeks to evenly balance the interests of parties.[268]

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263 Companies Act, s 4.

264 At 253.

265 *Levin v Ikiua* (HC), above n 1, at [97]; Taylor and Slevin, above n 23, at 1187; ALRC, *General Insolvency Inquiry*, above n 11, at 239; NZLS, *Trust Law Conference*, above n 68, at 51.

266 D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 305.

267 Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 186; D'Angelo "the trust as a surrogate company: the challenge of insolvency", above n 21, at 307; Hudson, above n 14, at 167-74.

268 Evidenced in the long title of the Companies Act.

F Conclusion

Early fears and harsh criticisms of the trading trust neglected the role the Companies Act (and the Corporations Act in Australia)[269] would have in regulating the trading trust; Ford's 'commercial monstrosity' thesis has been unfounded.[270] The duties owed by a director in Part 8 of the Act provide a significant answer to the risks of the trading trust to creditors.[271] The Trusts Act has also strengthened the position of the creditor seeking subrogation.[272] Where the gap remains however is that a trading trust creditor is more easily prejudiced than a creditor of an ordinary company by distributions.

Courts have long recognised a trustee's indemnity and the creditor's subrogation to this right. Another means of recovery for the trust creditor may simply be the next logical step as the use of trusts continue to change and more regard is had to the rights of the creditor. Chapter Four will explore a further means of the trading trust's creditor to seek recovery of distributions in applying *Re Diplock* to trading trusts.

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269 Corporations Act (Aus) 2001.

270 Ford "Trading Trusts and Creditor Rights", above n 12. See also Ford and Hardingham, above n 1; Williams "Winding up Trading Trusts: Rights of Creditors and Beneficiaries", above n 11; McPherson, above n 1.

271 Heath "Bringing Trading Trusts into the Company Line", above n 16, at 537-9.

272 Trusts Act, s 86.

IV A 'New' Approach

A question that has remained open for decades, with no definitive answer, is whether *Re Diplock* can apply outside the administration of deceased estates to confer upon the creditor of a trustee a direct claim in equity against the recipients of a wrongful payment of trust property.[273] This Chapter analyses the possibility of *Diplock* assisting the creditor of the trading trust. It is submitted that while *Diplock* is able to assist the trading trust creditor, the more appropriate move is to incorporate *Diplock* into the Trusts Act (discussed in Chapter Five). This will achieve *Diplock's* effect in providing greater creditor protection, but achieve additional clarity and certainty in the law.

A The Case of *Re Diplock*

Firstly, the facts. The deceased, Caleb Diplock, died in 1936 leaving his residuary estate "for such charitable institutions or other charitable or benevolent object or objects in England …"[274] His executors, not knowing this provision was void for uncertainty,[275] distributed over £200,000 to 139 charitable institutions.[276] The plaintiffs, the deceased's next of kin, sought judgment against these institutions. The plaintiffs alleged both personal claims against the recipients and proprietary claims (insomuch as the funds could be traced into the hands of the recipients).[277] For current purposes, the relevant claim is the personal equitable claim.

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[273] *Halsbury's Laws of England* (5th ed, 2019) vol 98 Trusts and Powers at [692]; *Halsbury's Laws of Australia* (reissue, 1995) vol 27 Trusts at [430-5630]; Heydon and Leeming, above n 25, at [2320]; Ford and Lee, *Principles of the Law of Trusts*, above n 25, at [1730]; Lord Goff and Jones, above n 25, at [30-002]-[30-003](The text has since changed hands from the original authors. The same discussion regarding the further application of *Diplock* does not appear in the newer editions.).
[274] *Ministry of Health v Simpson*, above n 24, at 1137.
[275] Declared void in *Chichester Diocesan Fund and Board of Finance v Simpson* [1944] AC 341.
[276] At 1137.
[277] *Re Diplock*, above n 24, at 466.

With respect to this claim, the House of Lords declared the reasoning of the Court of Appeal to be unimpeachable;[278] leading to the conclusion that, where the executors of a deceased estate have paid to persons that were not entitled to the payment, the next of kin or creditors can recover that payment from the recipient, assuming they are not a bona fide purchaser.[279]

The authority for this proposition stretched back three hundred years,[280] but was summarised by Lord Davey in *Harrison v Kirk*:[281]

> "But the Court of Chancery, *in order to do justice and to avoid the evil of allowing one man to retain what is really and legally applicable to the payment of another man*, devised a remedy by which, *where the estate had been distributed* either out of court or in court *without regard to the rights of a creditor, it has allowed the creditor to recover back what has been paid to the beneficiaries* or the next of kin who derive title from the deceased testator or intestate."

This statement explained the 'evil' to be avoided and its remedy.[282] There is no suggestion the payment be a mistaken one; all that is required is that the payment be sourced from the deceased's estate.[283]

For the purpose of this dissertation, the significance of *Diplock* and the embedded authorities rests in the protection for the creditors of the estate. The embedded authorities, evidenced well in *Harrison*, demonstrate that for centuries the courts have been concerned to protect a creditor from being prejudiced by estate funds being distributed while debts remain unpaid. *Diplock* was a novel case in that never before had an

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[278] At 1140.
[279] At 1140; Lord Goff and Jones, above n 25, at [30-002].
[280] At 1140.
[281] *Harrison v Kirk* [1904] AC 1 at 7 (emphasis added).
[282] At 1141.
[283] At 1141.

underpaid beneficiary of an estate been conferred the right to proceed directly against a wrongly paid recipient.[284]

B Diplock's Application to Trading Trusts

It must be recognised that the House of Lords focused the application of this remedy in the context of estate administration, and obiter comments suggest that there is no comparable rule in the law of trusts.[285] Subsequent courts and commentators however have begun extending this reasoning to trusts.[286] It will be demonstrated that this reasoning is just as applicable to trading trusts as it is to deceased estates. In some jurisdictions, such as Queensland, any doubt of this application has been removed by the legislature.[287]

In *Ron Kingham Real Estate Pty Ltd v Edgar* a trading trust had distributed all trust assets to beneficiaries, who were also the directors of the corporate trustee.[288] The result was to leave the trustee's indemnity worthless.[289] The liquidators succeeded in a claim however that the trustee was entitled to be indemnified by the beneficiaries personally, and the liquidator could be subrogated to this right.[290] The case was unusual in that there was no trust deed in evidence and the Court disregarded the evidence that suggested the beneficiaries were discretionary.[291] Such an odd factual circumstance cannot be relied upon for the totality of trading trusts: any slightly informed trading trust director would ensure that the beneficiaries will not be liable to indemnify the trustee.

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[284] Lionel Smith "Unjust Enrichment, Property, and the Structure of Trusts" (2000) 116 LQR 412 at 438.

[285] At 1140.

[286] *Re J Leslie Engineers Co Ltd*, above n 25; *Butler v Broadhead* [1974] 3 WLR; *Ron Kingham Real Estate Pty Ltd v Edgar*, above n 23; *Halsbury's Laws of England* (5th ed, 2019) vol 98 Trusts and Powers at [692]; *Halsbury's Laws of Australia* (reissue, 1995) vol 27 Trusts at [430-5630]; Heydon and Leeming, above n 25, at [2320]; Ford and Lee, *Principles of the Law of Trusts*, above n 25, at [1730].

[287] Trusts Act 1973 (Qld) s 113.

[288] *Ron Kingham Real Estate Pty Ltd v Edgar*, above n 23, at 441.

[289] At 441.

[290] At 441

[291] At 442.

Although not determinative for the case, Davies JA made important comments on the claim in s 109 Trusts Act 1973 (Qld)[292] on wrongful distribution of trust property (see appendix). This section provides anyone who has suffered loss following a wrongful distribution of trust property with a personal claim against the recipient. He stated s 109 was an additional source of the right to claim against the recipients of trust property, rather than a new instance of recovery.[293] It seemed the Queensland Law Reform Commission were of this opinion also. In their report they stated s 109 "ends this doubt [regarding *Diplock* applying to trusts] by giving a statutory personal right of recovery in every case."[294] This language suggests that this section was simply a clarification, rather than creating a new claim.

Diplock's extension has been considered in application to companies. In *Butler v Broadhead* the liquidator had mistakenly conveyed company property to shareholders; this property should have been available to the Company's creditors on liquidation.[295] The plaintiffs unsuccessfully claimed the defendants had been unjustly enriched at the expense of the plaintiffs.[296] Although Templeman J held that the Companies Act and the relevant Winding Up Rules barred the plaintiff's claim,[297] he considered that there was sufficient similarity between the position of an executor and a liquidator (in the duty of paying debts and distributing remaining assets) to enable equity to intervene.[298] The Judge stated "the principle of the *Diplock* case must apply in toto or not at all and that there cannot be some safe halfway house."[299]

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292 Now s 113.
293 At 440.
294 At 73-74.
295 *Butler v Broadhead*, above n 25, at 30.
296 At 30.
297 At 37; Companies Act 1948 (UK).
298 At 34.
299 At 36.

The extension of *Diplock* has been considered in several other cases too.[300] However that proposition only received brief consideration as factual circumstances have been fatal to the claim, such as not fully exhausting remedies against the trustee personally.[301]

Many academics also favour the extension of *Diplock*. Goff and Jones cite *Butler v Broadhead* for support that courts are prepared to extend the *Diplock* action to enable beneficiaries and creditors of inter vivos trusts to proceed directly against the recipients of trust assets.[302]

Ford and Lee noted that the main reason in *Diplock* to impose personal liability was that, 'an invalid disposition cannot confer any equitable title in the recipient', is stated too broadly to be restricted to deceased estates.[303] Also, the imposition of personal liability upon recipients of trust property will assist the creditor who has a fruitless claim against an asset-less trustee or to their right of indemnity.[304]

So too does Philip Pettit in *Equity and the Law of Trusts*.[305] After citing *Butler v Broadhead* the author states it now appears that a claim could be made based on unjust enrichment, allowing the trustee or creditor to recover back what was wrongly paid to the beneficiary, subject to defences available.[306]

For the sake of completeness, it should be noted here is authority against *Diplock* applying to trusts. However, such authority cannot be taken as conclusive against the extension of *Diplock*, but should merely be restricted to the ability of the trustee to recover from an overpaid beneficiary out of future payments. In *Burns v Leda Holdings*

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300 *GL Baker Ltd v Medway Building and Supplies Ltd* [1958] 3 All ER 540; *Eddis v Chichester Constable* [1969] 1 All ER 546; *Re J Leslie Engineers Co Ltd*, above n 25; *Hagan v Waterhouse* (1991) 34 NSWLR 308.

301 For instance: *Re J Leslie Engineers Co Ltd*, above n 25, at 299; *Hagan v Waterhouse*, above n 300, at 370.

302 Lord Goff and Jones, above n 25, at [30-002].

303 Ford and Lee, *Principles of the Law of Trusts*, above n 25, at [1730].

304 At [1730].

305 Philip H. Pettit, *Equity and the Law of Trusts* (12th ed, Oxford University Press, 2012) at 551.

306 At 551. Defences include change of position.

Pty Ltd the Company had been trustee of a unit trust of which the respondents were unit holders.[307] The Trust was involved in the purchase of real estate and distributed the profits of this to the unit holders, following which the Trust was terminated. A month later, notice of assessment of stamp duty arrived that was higher than expected with no funds to meet this.[308]

The liquidators unsuccessfully argued a claim in equity against the unit holders.[309] Dowsett J held that where a beneficiary has been overpaid, the trustee may deduct this from any amounts further due to the beneficiary, but the beneficiary cannot be expected to repay these amounts personally.[310] *Downes v Bullock*[311] and *Jacobs' Law of Trusts in Australia*[312] were referred to as the main authorities for this proposition.[313] The basis of this rule is the inequity in expecting a wrongly paid beneficiary to be able to repay such overpayments.[314] However the Judge admitted himself that this is unsatisfactory in the context where the beneficiaries were essentially in control of the corporate trustee.[315] Dowsett J also believed s 109 Trusts Act (Qld), when taken with the *Diplock* litigation, to be an indication that without this section, there would be no right of recovery against the recipients of trust property.[316] In an instance of astonishing oversight however, the liquidators did not make their claim under this section but opted to establish a claim in equity.[317]

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307 *Burns v Leda Holdings Pty Ltd*, above n 23, at 366.

308 At 366.

309 At 365.

310 At 378; *Downes v Bullock*, above n 144; RP Meagher and WMC Gummow , *Jacobs' Law of Trusts in Australia* (5th ed, Buttersworth, 1986) at [1731]. See also *Halsbury's Laws of Australia* (reissue, 1995) vol 27 Trusts at [430-4200].

311 *Downes v Bullock,* above n 144.

312 RP Meagher and WMC Gummow , *Jacobs' Law of Trusts in Australia* (5th ed, Buttersworth, 1986).

313 At 378.

314 *Burns v Leda Holdings Pty Ltd*, above n 23, at 379.

315 At 379.

316 At 379.

317 At 385.

To demonstrate that *Burns* cannot be taken as conclusive against the extension of *Diplock*, regard must be had to the authorities relied upon by Dowsett J and his reasoning. *Burns* demonstrates well the problem in uncritically applying old trust cases, which seek to protect beneficiaries in disregard to others interests, in a modern commercial setting. *Downes v Bullock*[318] was taken as authority that a beneficiary cannot be called upon to recover overpayments. In *Downes* a father had settled a trust where following his death, his son and the son's wife would receive dividends for life.[319] If the son died without any children, then the father's next of kin would receive the residue. The son died without any children and the residue was distributed to the father's four daughters.[320] However, as the persons entitled to the residue were taken at the time of the death, the son also had an interest that was not accounted for, meaning the daughters had been overpaid.[321] Sir John Romilly MR held the Court had no power to compel the daughters to refund anything which had been paid to them.[322] Compare this situation with *Burns* where unit holders had received distributions before a higher than expected assessment of stamp duty was received, but the Trust had already been terminated.

It is easier to see why a court in the 1850s, who may have been more influenced by broad notions of fairness and an eagerness to protect beneficiaries, would be reluctant to order the daughters of a deceased, who had previously not been provided for at all by their father, until their brother's death, to refund money to the brother's personal representatives, after the son and his widow already received a life interest. In such factual situations, it may indeed be inequitable to expect the beneficiary to repay the overpayments.[323] It is hard to see such general unfairness however with *Burns* in ordering investors to refund money received before the corporate trustee's actual liability was assessed and paid. Indeed such situations may be a chief reason the Queensland legislator ensured *Diplock* applied to all trusts.

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[318] *Bullock v Downes* (1860) 9 HL Cas 1; (1860) 11 ER 627.

[319] At 627.

[320] At 627.

[321] At 627.

[322] *Downes v Bullock*, above n 144.

[323] *Burns v Leda Holdings Pty Ltd*, above n 23, at 379.

Jacobs' Law of Trusts previously supported the proposition that an overpaid beneficiary cannot be expected to repay any overpayments.[324] The current edition now however criticises *Downes* as "an old and unduly broad authority" in not taking into account the possibility of the trustee recovering moneys paid with the remedy of money had and received.[325]

As noted, the case was not pleaded under the Trusts Act (Qld) which provides a right of recovery for wrongful distributions of trust property. Dowsett J took the legislation as creating a new claim for the trust creditor.[326] However when one reads the supplementary material to the Act, it is clear that the drafters did not intend to create a new claim, but intended to end any doubts on *Diplock's* application to trusts.[327] For that reason, Davies JA interpretation in *Edgar* of s 109 is more apt.[328] As the claim was not brought before the Court under the section which clearly catered for this situation, the reason not to extend the equitable claim may have been more about strictness to pleadings than strictly legal ones. For the reasons noted, *Burns* cannot be safely taken as authority against *Diplock* applying to trusts.

Diplock applies to trading trusts for two reasons. Firstly, a trustee has no more power than an executor to confer equitable title through an invalid disposition.[329] But the principle is wider than this: it is not necessary to prove such a mistake for equity to intervene.[330] *Diplock* involved a mistake of law as the executors were not aware the provision of the will was void for uncertainty, and the executors therefore lacked authority to make such

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324 RP Meagher and WMC Gummow , *Jacobs' Law of Trusts in Australia* (5th ed, Buttersworth, 1986) at [1731].

325 Heydon and Leeming, above n 25, at [1737].

326 Heydon and Leeming, above n 25, at [1737].

327 Queensland Law Reform Commission, *On the Law Relating to Trusts, Trustees, Settled Land and Charities* (QLRC, r 8) at 73-4.

328 *Ron Kingham Real Estate Pty Ltd v Edgar*, above n 23, at 440. See above.

329 Ford and Lee, *Principles of the Law of Trusts*, above n 25, at [1730].

330 *Ministry of Health v Simpson*, above n 24, at 1143.

distributions. Although at the time mistakes of law were not recoverable,[331] this did not prevent the equitable action applying. The authorities relied upon in *Diplock* were never concerned about mistakes, whether it be of fact or law;[332] what was relevant was the receiving of funds had without regard to the rights of the creditor.[333] The House of Lords recognised that nature of the mistake had never been relevant in applying the equitable doctrine.[334] The action applies regardless of the type of mistake in play *or even a deliberate action* on the part of the executor in allowing relief for the claimant.[335] Whatever the reasons the distributor had in making the payment should not act to the detriment of the innocent creditor or next of kin – such a restriction would unrecognisable to equity.[336] It is not necessary for the claimant to prove a mistake on the part of the distributor to seek recovery under *Diplock*.[337] Therefore, secondly, a creditor of the trading trust is just as vulnerable, if not more so than a deceased's creditor, to being prejudiced by distributions made in disregard to their interests, enabling equity to intervene.[338]

To simply place a line around *Diplock* to administering estates is arbitrary.[339] Taking the first reason above, to hold that *Diplock* only applies in the administration of deceased estates implies what while an executor cannot confer equitable title through an invalid disposition, a trustee can.

The importance of *Diplock* however lies in the protection to creditors, next of kin and legatees against acts of an executor. A trustee and an executor are not in the exact same

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[331] There is no longer a distinction between mistakes of fact and law now: overturned in Australia in *David Securities Pty Ltd v Commonwealth Bank of Australia* [1992] HCA 353 and in England in *Kleinwort Benson Ltd v Lincoln CC* [1999] 2 AC 349. This had been the case in New Zealand based on statute: Judicature Act 1908, s 94A; now Property Law Act 2007, s74A.

[332] *Ministry of Health v Simpson*, above n 24, at 1143.

[333] *Harrison v Kirk*, above n 291, at 7.

[334] *Ministry of Health v Simpson*, above n 24, at 1143.

[335] *Ministry of Health v Simpson*, above n 24, at 1143.

[336] At 1143.

[337] See *Public Trustee v Flower* (1991) 13 NZTC 8,042, (1990) TRNZ 97 at 7.

[338] Ford and Lee, *Principles of the Law of Trusts*, above n 25, at [1730].

[339] *Butler v Broadhead*, above n 25, at 36.

position, but they are similar. Like the trust, the deceased estate lacks capacity from those who administer it.[340] Dealing with others in differing capacities can affect one's interests and rights to property.[341] Problems for creditors arose in assets being distributed before creditors' claims were made or the estate being insufficient to meet the deceased's debts. The courts and later the legislature developed rules to remedy this.[342] *Diplock* can be seen as a somewhat recent solution/restatement to the problem facing creditors of estates, that funds legally applicable to them have been distributed without regard to creditor claims.

This problem does not solely belong to the deceased estate however. Creditors of a trading trust are in a precarious position and are susceptible to this risk of assets being distributed without regard to their interests.[343] The corporate trustee has no assets of its own so the creditor is reliant on the trustee's indemnity,[344] which is in turn reliant on there being trust assets.[345] The trading trust however will be eager to distribute assets quickly as the assets are safest in the hands of the beneficiaries. The creditor of the trading trust and the deceased might be in the exact same position, but the law displays differing treatment of the two. Both creditors may have been prejudiced by distributions and exhausted all personal remedies against the distributor, but this is insufficient. The differing treatment of law is that it is beyond doubt that the creditor of the deceased would have a direct claim in equity against the recipient of this distribution. At the very least it is unclear whether the trustee's creditor has the same right.

Take the statement from *Harrison v Kirk* quoted above.[346] For centuries courts have been concerned about the creditor of an estate. Therefore they devised a remedy to avoid the 'evil' in one man receiving funds applicable to the payment of another. It is no less evil for someone to receive such funds having derived their title from the trustee than

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[340] Taylor and Slevin, above n 23, at 1203.
[341] Taylor and Slevin, above n 23, at 1203.
[342] Taylor and Slevin, above n 23, at 1203.
[343] For instance: *Levin v Ikiua* (HC), above n 1; *Burns v Leda Holdings Pty Ltd*, above n 23; *Ron Kingham Real Estate Pty Ltd v Edgar*, above n 23.
[344] Ford and Hardingham, above n 1, at 50.
[345] Taylor and Slevin, above n 23, at 1190.
[346] Above n 291, at 7.

someone who derives their title from the deceased. Either way, the creditor is left out of pocket.

Much of trust law is rooted in beneficiary favouring principles,[347] evidenced well in *Downes v Bullock*. The trust is constantly evolving however and such principles cannot be coherently applied in perpetuity.[348] Recognising a creditor's direct claim against the recipient beneficiary would simply recognise how trusts are being used and the position of the creditor in being vulnerable to distributions.

In some regards, recognising this personal claim would change little. This would not be the only instance where the interests of the beneficiaries to trust property is secondary. Support for such a claim can also be found in the trustee's right of indemnity, giving rise to a proprietary interest and having priority over the beneficiaries.[349]

C The Trustee's Right of Indemnity and the Entitlements of the Beneficiary

To demonstrate the limits on what a beneficiary is entitled to, regard must be had to the trustee's right of indemnity. The beneficiary is not the only one with an interest in trust property, and this interest is secondary to the trustee's.[350] Recognising the creditor's personal claim against the recipient beneficiary is simply to be consistent with and will 'give teeth' to the trustee's right of indemnity.

[347] UK Trust Law Committee, *Rights of Creditors Against Trustees and Trust Funds*, above n 29, at [1.5]; Crossland "Unsecured creditors and the 'Uncorporation': issues with trading trusts post financial crisis", above n 12, at 186; Hudson, above n 14, at 168-173; Waters, above n 14, at 78.
[348] Hudson, above n 14, at 175.
[349] *Octavo Investment Pty Ltd v Knight*, above n 209, at 367.
[350] *Octavo Investment Pty Ltd v Knight*, above n 209, at 367; *Belar Pty Ltd (in liq) v Mahaffey* [2000] 1 Qd R 477; [1999] QCA 002 at [20]; *Chief Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226 at [48]-[51].

When a trustee incurs a liability in execution of the trust, they have a right of recoupment out of trust property in satisfaction of this debt.[351] This right of recoupment provides the trustee with a proprietary interest in trust property.[352] This interest enjoys priority over the beneficiaries.[353] Therefore, although property is held on trust, this does not necessarily mean that the beneficiary is entitled to the delivery of that property.[354] The beneficiary is only entitled to net proceeds after discharging liabilities.[355]

Professor Ford criticised *Octavo* in holding that the trustee's right of exoneration also gives rise to a proprietary interest in trust property; he argues that this is better charactered as a fiduciary power.[356] However, it is beyond doubt that the trustee's right of recoupment gives rise to a proprietary interest.[357] This was recognised by the Court of Appeal in *Levin*.[358] It is this right of recoupment which limits the entitlement of the beneficiary to net proceeds after discharging liabilities.

Judges and commentators have long emphasised the importance of the trustee's indemnity.[359] In *Worral v Harford* it was stated that the right of indemnity is an incident of the office of trustee and inseparable from it.[360] Similarly, in *Hardoon* it was stated that the right of indemnity is "as old as trusts themselves" and that the plainest principles of

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351 Trusts Act 2019, s 81.

352 *Octavo Investment Pty Ltd v Knight*, above n 209, at 367; *Levin v Ikiua* (CA), above n 197, at [53].

353 *Octavo Investment Pty Ltd v Knight*, above n 209, at 367; *Re Griffith* [1904] 1 Ch 807; *Jennings v Mather* [1902] 1 KB 1 (CA) at 6 and 9.

354 *Octavo Investment Pty Ltd v Knight*, above n 209, at 369.

355 *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties (QLD)* [1984] 1 Qd R 576 at 587.

356 Ford "Trading Trusts and Creditor Rights", above n 12, at 4.

357 Williams "Winding up Trading Trusts: Rights of Creditors and Beneficiaries", above n 11.

358 *Levin v Ikiua* (HC), above n 1, at [53].

359 *Re Johnson*, above n 10, at 550; *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties (QLD)*, above n 355, at 585; *Moyes & Anor v J & L Developments Pty Ltd & Anor (No 2)* [2007] SASC 261; McPherson, above n 1, at 149-50; Kalev Crossland "Trading Trusts", above n 12, at [46.3]; Heath "Bringing Trading Trusts into the Company Line", above n 16, at 527-533. For a contrary view see *RWG Management Ltd v Cmr for Corporate Affairs* [1985] VR 385; Heydon and Leeming, above n 25, at [2106]; GE Dal Pont, above n 1, at [23.155].

360 *Worrall v Harford*, above n 10, at 8.

justice require the beneficiary who receives the benefit of property should also bear its burden.[361]

Although the importance of the trustee's right of indemnity is well recognised, it is too easily rendered worthless by distributions. This is of particular concern for the trading trust creditor who may be entirely reliant on the trustee's indemnity. Once assets have been distributed to beneficiaries, the right of indemnity out of trust assets is taken to be extinguished.[362] It is extraordinarily easy to exclude a right of indemnity from beneficiaries personally.[363] Although it was beyond doubt in *Levin* that OPC had a proprietary interest in trust property in relation to the expenses incurred as trustee,[364] it seemed little could be done once the trading profits had been distributed to the beneficiaries.

Recognising a creditor's personal claim against the recipient beneficiary is then simply consistent with and a means to properly enforce the trustee's right of indemnity. If a creditor has such a claim, then it strengthens the primacy of the trustee's interest in trust property, as the trustee would be able to discharge liabilities where personal and trust assets are not sufficient to meet the debts. It would also ensure that the beneficiary is indeed only receiving net proceeds after discharging liabilities.[365] This claim of the creditor against the recipient beneficiary simply 'gives teeth' to the trustee's indemnity where it is currently rendered worthless if assets have been distributed. After all, beneficiaries are not entitled to assets not paid for.

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361 *Hardoon v Belilios*, above n 36, at 123-4.

362 UK Trust Law Committee, *The proper protection by liens, indemnities or otherwise of those who cease to be trustee* ((Tolley Publishing, London, 1999) at [33].

363 This right can easily be excluded: *Wise v perpetual Trustee Co*, above n 48; *Hardoon v Belilios*, above n 36, at 127; *RWG Management Ltd v Cmr for Corporate Affairs* [1985] VR 385 at 394-5; *Ron Kingham Ron Kingham Real Estate Pty Ltd v Edgar*, above n 23, at 442 per McPherson J; Heydon and Leeming, above n 25, at [2106]; Kalev Crossland "Trading Trusts", above n 12, at [46.3].

364 *Levin v Ikiua* (CA), above n 197, at [54].

365 *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties (QLD)*, above n 355, at 587.

D Progression in the Law

The law cannot and should not stay static. If new instances of recovery were not recognised then the law would be condemned to ossify for no apparent reason.[366] Fears of ‘palm tree justice’ may be justified if recovery was awarded on no ground other than a particular judge’s sentiment.[367] However, when the case is made with a direct analogy with previous authority, and the reasoning is equally applicable, then there seems little reason not to award recovery.[368]

E Conclusion

Diplock and the cases relied upon provided a necessary means of creditor protection in the administration of deceased estates. The embedded authorities protected the creditor where *Diplock* extended this to the next of kin or legatees.[369] Creditors of the estate were vulnerable to assets being distributed before accounting for the deceased’s debts, and the personal liability of the executor for such acts may be insufficient.[370] The courts in response devised a remedy where the creditor (and later next of kin or legatee) would have a direct claim in equity against the recipient of the distribution.

The same risks are applicable to the trust creditor, particularly the trading trust. In this case, the trustee’s personal assets are unlikely to be able to meet liabilities and the trustee’s indemnity is vulnerable to being rendered worthless by distributions. Directors duties and other CA provisions cannot always be relied upon. Recognising this claim is simply to recognise the potentially vulnerable position of the creditor.

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[366] *Gibb v Maidstone and Turnbridge Wells NHA Trust* [2010] EWCA Civ 678; [2010] IRLR. 786 at [26]

[367] *Gibb v Maidstone and Turnbridge Wells NHA Trust*, above n 366, at [26].

[368] At [27].

[369] See *Noel v Robinson* (1682) 1 Vern 90; 23 ER 334; *Orr v Kaines* (1750) 2 Ves Sen 194; 23 ER 125; *David v Froud* (1833) 1 My & K 200; 2 LJ Ch 68; 39 ER 657.

[370] Taylor and Slevin, above n 23, at 1203.

It is submitted that equity is able to assist the creditor of the trading trust in conferring a direct personal claim against the recipient of a wrongful distribution of trust property. The reasoning of *Diplock* and earlier authorities is just as applicable to trusts as it is to deceased estates; *Diplock* must apply in toto or not at all.[371] This is not the only means to bolster the position of the creditor however. Statute could remedy this situation in regulating distributions of trust property. Chapter Five explores this.

[371] *Butler v Broadhead*, above n 25, at 36.

V Statutory Reform

Regulating distributions by trading trusts has been considered by the Law Commission.[372] The recommended solvency test for trading trusts was misplaced in that it unnecessarily imposed extra liability upon directors of trading trusts while continuing to over protect beneficiaries. The considerations do however recognise a regulatory gap in distributions of trust property and the vulnerability of the creditor in being prejudiced by distributions. Incorporating *Diplock* into the Trusts Act, as Queensland has done, is the most appropriate means to provide creditors of the trading trust with the protection deserved.

A The Law Commission's 2002 Recommendations

The distribution regime's non-application to trading trusts has been noted. In 2002 the Law Commission recommended inserting into the Trustee Act:[373]

> "A trading trust may make a distribution to a beneficiary of the trust only if the same requirements as are prescribed by the Companies Act 1993 section 52 (relating to the solvency test) have been satisfied, and in the event of a breach of this provision, the directors and officers of the trading trust will be under the same criminal liability and the same personal liability to make repayments as are directors of a company under the Companies Act 1993 sections 52(5) and 56."

This was never enacted however, possibly largely because of negative responses from submitters.[374] Some thought that compliance would place too great a burden on

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372 NZLC, *Some Problems in the Law of Trusts*, above n 46; NZLC, *fifth issues paper*, above n 1.
373 At [29]. The recommendations were made at the time of the Trustee Act 1956.
374 NZLC, *fifth issues paper*, above n 1, at [6.25].

trustees.[375] In 2011 the Commission re-considered the use of trading trusts but paid little consideration to extending the distribution regime to trading trusts.[376]

The main problem with this proposal is its target on directors. As Hart noted, this would be harsher than the regime in the CA as s 56 provides for recovery from the shareholder.[377] This proposal however simply places all the burden upon directors. This extra liability is unnecessary as directors of trading trusts are still subject to the exact same duties in Part 8 of the Act.[378] The problem posing creditors of trading trusts is that beneficiaries are over protected when compared to other residual owners such as shareholders. The external reviewer also expressed concerns about the 'brief-cross-reference technique' creating uncertainty as to how the rules relating to distributions would apply.[379]

This recommendation by the Law Commission does not adequately address the problem of trading trusts for creditors. Rather than focusing on the distributions themselves which may prejudice creditors, it sought to focus upon the solvency of corporate trustees and impose greater liability upon directors. A provision which enables a creditor to recover a distribution from the recipient is a more effective and appropriate remedy. Some problems with the previous proposal could be resolved by incorporating the distribution regime in full into the Trusts Act. However, given the case has been made that equity can already assist the trading trust creditor, a provision that incorporates *Diplock* is preferred to achieve consistency and clarity in the law, rather than changing it. This will also be more consistent with the general law of trusts.

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[375] NZLC, *fifth issues paper*, above n 1, at [6.25].

[376] The paper mainly noted the recommendation and the negative responses: NZLC, *fifth issues paper*, above n 1, at [6.25].

[377] John Hart "Trading Trusts" (paper presented to New Zealand Law Society Trusts Conference, 2003) at 160.

[378] Heath "Bringing Trading Trusts into the Company Line", above n 16, at 537-9.

[379] David Goddard "NZLC 79 – 'Some Problems in the Law of Trusts' – Implementation" (Draft Memorandum prepared for Ministry of Justice, 6 May 2007) at 5.

B Statutory Incorporation of Diplock

Incorporating *Diplock* is the most appropriate response to the use of trading trusts, bringing the law of trusts and administration of estates together in terms of wrongful distributions.[380] The effect of this section would be similar to the distribution regime in the Act in that it provides the creditor who has suffered because of a wrongful distribution with a direct personal claim against that recipient.[381] It also however maintains the personal liability of the trustee by requiring the claimant (except with leave of the court) to first exhaust all remedies against the trustee personally;[382] and it enables a change of position defence, in line with the general law of unjust enrichment[383] and is consistent with the shareholders defence in s 56.[384]

This section is reasonably wide as it applies to trusts generally. Trading trusts have been the focus of this dissertation and Law Commission reports. However, if the discussion regarding the position of the creditor and the entitlements of a beneficiary holds, this same reasoning is applicable to trusts generally; trading trusts simply bring the problem to the forefront. The rights of a beneficiary will generally be the same under the trading trust as any other trust,[385] and there is nothing about being a beneficiary which entitles one to assets not paid for.[386] The trustee's indemnity and subrogation sought to prevent this but proved inadequate when all assets had been distributed.

Also, if such a section was restricted to trading trusts then the problem of definitively defining a trading trust arises.[387] Having a statutory definition might simply invite some to try and modify their chosen trading vehicle to escape the set definition and restrictions.

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[380] Trusts Act 1973 (Qld), s 113. See appendix.

[381] Trusts Act 1973 (Qld), s 113(1); Companies Act, s 56(1).

[382] Trusts Act 1973 (Qld), s 113(2).

[383] *Limpkin Gorman v Karpnale Ltd* [1991] AC 548 (HL).

[384] Trusts Act 1973 (Qld), s 113(3); Companies Act, s 56(1).

[385] Ford and Hardingham, above n 1, at 55.

[386]*Octavo Investment Pty Ltd v Knight*, above n 209; *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties (QLD)*, above n 355, at 587.

[387] NZLC, *fifth issues paper*, above n 1, at [8.32]-[8.34].

If the analysis in Chapter Four is accepted, then the creditor already has such a remedy against the recipient, but this is not to be without difficulties. Providing for such a remedy in statute however will enable all the benefits that come statute based law: it is accessible (even to the non-expert), clear and certain, and its authority is unquestioned.

The extension of *Diplock* outside of deceased estates is the next logical step. Firstly, trustee has no more power to provide equitable title through an invalid disposition than an executor does. But the principle is wider than this. Equity was concerned with simply the position of the creditor and the receipt of funds legally applicable to the payment of another.[388] Accordingly, there is no need to prove a mistake for the equitable action of *Diplock*.[389] The creditor of the trustee may be left just as vulnerable following a distribution as a deceased's creditor is: in either situation, personal claims against the distributor may be worthless in satisfying the debt. If anything, creditors of trading trusts are more vulnerable given the corporate trustee's lack of assets and readiness to distribute property held on trust.

Similarly, while creditors of the ordinary company could pursue shareholders for insolvent distributions of company property, no such right existed for creditors of the trading trust for similar distributions of trust property. The creditor was left more vulnerable in dealing with a company depending on the company acting as trustee. There is no convincing reason for this, particularly as the creditor may be unaware the company acts as trustee.

Lessons can be learnt from other branches of law that have over time improved the position of creditors. Partnerships were once the predominant legal structure for combining assets in pursuit of trade.[390] Like the trust, it also lacks its own legal personality. In this context, rules were developed to ensure that the partnerships assets

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388 *Harrison v Kirk*, above n 291, at 7; *Ministry of Health v Simpson*, above n 24, at 1141.

389 *Ministry of Health v Simpson*, above n 24, at 1143; See *Public Trustee v Flower*, above n 337, at 7.

390 Taylor and Slevin, above n 23, at 1203.

can be made available to all creditors of a bankrupt partner or partners.[391] The company's position to creditors has changed much over the centuries and in recent times, while the internal relationship has stayed largely the same.[392] For instance, it was once necessary for a debtor company to intend to prefer one creditor over another to attract the voidable preference regime, but is no longer necessary.[393] The distribution regime in the Act also helped to strengthen the position of the creditor.[394] Such other areas show that change is possible and indeed may be required to ensure the fair treatment of the creditor.

For these reasons, incorporating *Diplock* into the Trusts Act is favoured. This will ensure creditors of the trading trust are adequately protected and beneficiaries do not remain overly protected in the receiving of distributions.

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391 Taylor and Slevin, above n 23, at 1203.

392 UK Trust Law Committee, *Rights of Creditors Against Trustees and Trust Funds*, above n 29, at [1.3].

393 Murray Tingey and Nick Moffat "Antecedent Transactions", above n 190, at [24.2].

394 NZLC, *Company Law Reform and Restatement*, above n 28, at [333].

Conclusion

The examination of trading trusts has shown a gap in the law. It is difficult to find a convincing reason why the creditor of a trading trust should have less protection in regards to distributions than a creditor of an ordinary company, a deceased and even more a traditional trustee.

Although the trustee takes on personal liability (unless expressly excluded), this personal claim is worthless against an asset poor company. The trustee's indemnity and subrogation will too be worthless if all assets have been distributed. In such a case, the creditor of the trustee is in the exact same position as the deceased's creditor whose assets have been distributed and claims against the executor are insufficient. In response, the Court of Chancery devised a remedy where the creditor would have a direct claim against the recipient.[395] This reasoning is just as applicable to trusts as it is to deceased estates and the creditor of the trustee is equally deserving of protection. The trading trust brings this problem to the forefront as the trustee has no assets of its own and is likely to readily distribute assets held on trust (which can be done honestly).[396]

While the Companies Act sought to make the recovery of distributions simply dependent on the company's solvency and not on any fault of the board, the trading trust circumvented this. A trading trust creditor seeking recourse following distributions would need to show fault on behalf of directors or recipients.

Problems for the creditor stem from the historic function of trusts in protecting the vulnerable – principles regarding trusts accordingly favoured beneficiaries at the expense of outsiders. For decades cases have been coming before the court where a trading trust creditor has been left out of pocket following distributions.[397] There is no reason why the

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[395] Taylor and Slevin, above n 23, at 1203.

[396] *Levin v Ikiua* (HC), above n 1.

[397] *Octavo Investment Pty Ltd v Knight*, above n 209; *Burns v Leda Holdings Pty Ltd*, above n 23; *Ron Kingham Real Estate Pty Ltd v Edgar*, above n 23.

beneficiary should be protected in totality (the exception to this has been establishing claims such as dishonest assistance or knowing receipt). Gone are the days where the trust simply is left for the widow and children.[398] The trading trust is the paradigm example: it engages in risk inherent business ventures and is generally chosen to mitigate tax liability and avoid certain Companies Act provisions.

The protection afforded to beneficiaries in respect to distributions is undue. Being a beneficiary does not entitle one to distributions which prejudice creditor interests. As more regard is gradually being paid to the position of the creditor, historic principles of trust law are beginning to seem antique in a modern commercial setting.[399] Today the regulation of business entities seeks efficiency and a balancing of interest.[400] Relying on the conscience of the beneficiary to recovery a distribution is neither efficient nor fair for the creditor.

The case has been made for the extension of *Diplock*. However, incorporating this into statute is more appropriate. Given the above discussion, it is only right the recipient of a wrongful distribution of trust property be liable for its repayment, subject to one's good faith and change of position, which would make repayment inequitable.

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398 For instance, *Downes v Bullock*, above n 144.

399 Hudson, above n 14, at 174.

400 Companies Act, long title.

Appendix

Companies Act 1993 provisions

Section 4 Meaning of solvency test

(1) For the purposes of this Act, a company satisfies the solvency test if—

(a) the company is able to pay its debts as they become due in the normal course of business; and

(b) the value of the company's assets is greater than the value of its liabilities, including contingent liabilities.

(2) Without limiting sections 52 and 55(3), in determining for the purposes of this Act (other than sections 221 and 222which relate to amalgamations) whether the value of a company's assets is greater than the value of its liabilities, including contingent liabilities, the directors—

(a) must have regard to—

(i) the most recent financial statements of the company that are prepared under this Act or any other enactment (if any); and

(ia) the accounting records of the company; and

(ii) all other circumstances that the directors know or ought to know affect, or may affect, the value of the company's assets and the value of the company's liabilities, including its contingent liabilities:

(b) may rely on valuations of assets or estimates of liabilities that are reasonable in the circumstances.

(3) Without limiting sections 221 and 222, in determining for the purposes of those sections whether the value of the amalgamated company's assets will be greater than the value of its liabilities, including contingent liabilities, the directors of each amalgamating company—

(a) must have regard to—

(i) the most recent financial statements of each amalgamating company that are prepared under this Act or any other enactment (if any); and

(ia) the accounting records of the amalgamating company; and

(ii) all other circumstances that the directors know or ought to know would affect, or may affect, the value of the amalgamated company's assets and the value of its liabilities, including contingent liabilities:

(b) may rely on valuations of assets or estimates of liabilities that are reasonable in the circumstances.

(4) In determining, for the purposes of this section, the value of a contingent liability, account may be taken of—

(a) the likelihood of the contingency occurring; and

(b) any claim the company is entitled to make and can reasonably expect to be met to reduce or extinguish the contingent liability.

Section 52 Board may authorise distributions

(1) The board of a company that is satisfied on reasonable grounds that the company will, immediately after the distribution, satisfy the solvency test may, subject to section 53 and the constitution of the company, authorise a distribution by the company at a time, and of an amount, and to any shareholders it thinks fit.

(2) The directors who vote in favour of a distribution must sign a certificate stating that, in their opinion, the company will, immediately after the distribution, satisfy the solvency test and the grounds for that opinion.

(3) If, after a distribution is authorised and before it is made, the board ceases to be satisfied on reasonable grounds that the company will, immediately after the distribution is made, satisfy the solvency test, any distribution made by the company is deemed not to have been authorised.

(4) In applying the solvency test for the purposes of this section and section 56,—

(a) **debts** includes fixed preferential returns on shares ranking ahead of those in respect of which a distribution is made (except where that fixed preferential return is expressed in the constitution as being subject to the power of the directors to make distributions), but does not include debts arising by reason of the authorisation; and

(b) **liabilities** includes the amount that would be required, if the company were to be removed from the New Zealand register after the distribution, to repay all fixed preferential amounts payable by the company to shareholders, at that time, or on earlier redemption (except where such fixed preferential amounts are expressed in the constitution as being subject to the power of directors to make distributions); but, subject to paragraph (a), does not include dividends payable in the future.

(5) Every director who fails to comply with subsection (2) commits an offence and is liable on conviction to the penalty set out in section 373(1).

Section 56 Recovery of distributions

(1) A distribution made to a shareholder at a time when the company did not, immediately after the distribution, satisfy the solvency test may be recovered by the company from the shareholder unless—

(a) the shareholder received the distribution in good faith and without knowledge of the company's failure to satisfy the solvency test; and

(b) the shareholder has altered the shareholder's position in reliance on the validity of the distribution; and

(c) it would be unfair to require repayment in full or at all.

(2) If, in relation to a distribution made to shareholders,—

(a) the procedure set out in section 52 or section 70 or section 77, as the case may be, has not been followed; or

(b) reasonable grounds for believing that the company would satisfy the solvency test in accordance with section 52 or section 70 or section 77, as the case may be, did not exist at the time the certificate was signed,—

a director who—

(c) failed to take reasonable steps to ensure the procedure was followed; or

(d) signed the certificate, as the case may be,—

is personally liable to the company to repay to the company so much of the distribution as is not able to be recovered from shareholders.

(3) If, by virtue of section 52(3) or section 70(3) or section 77(3), as the case may be, a distribution is deemed not to have been authorised, a director who—

(a) ceased after authorisation but before the making of the distribution to be satisfied on reasonable grounds for believing that the company would satisfy the solvency test immediately after the distribution is made; and

(b) failed to take reasonable steps to prevent the distribution being made,—

is personally liable to the company to repay to the company so much of the distribution as is not able to be recovered from shareholders.

(4) If, by virtue of section 55(5), a distribution is deemed not to have been authorised, a director who failed to take reasonable steps to prevent the distribution being made is personally liable to the company to repay to the company so much of the distribution as is not able to be recovered from shareholders.

(5) If, in an action brought against a director or shareholder under this section, the court is satisfied that the company could, by making a distribution of a lesser amount, have satisfied the solvency test, the court may—

(a) permit the shareholder to retain; or
(b) relieve the director from liability in respect of—

an amount equal to the value of any distribution that could properly have been made.

Section 131 Duty of directors to act in good faith and in best interests of company

(1) Subject to this section, a director of a company, when exercising powers or performing duties, must act in good faith and in what the director believes to be the best interests of the company.
(2) A director of a company that is a wholly-owned subsidiary may, when exercising powers or performing duties as a director, if expressly permitted to do so by the constitution of the company, act in a manner which he or she believes is in the best interests of that company's holding company even though it may not be in the best interests of the company.
(3) A director of a company that is a subsidiary (but not a wholly-owned subsidiary) may, when exercising powers or performing duties as a director, if expressly permitted to do so by the constitution of the company and with the prior agreement of the shareholders (other than its holding company), act in a manner which he or she believes is in the best interests of that company's holding company even though it may not be in the best interests of the company.
(4) A director of a company that is carrying out a joint venture between the shareholders may, when exercising powers or performing duties as a director in connection with the carrying out of the joint venture, if expressly permitted to do so by the constitution of the company, act in a manner which he or she believes is in the best interests of a shareholder or shareholders, even though it may not be in the best interests of the company.

Section 133 Powers to be exercised for a proper purpose

A director must exercise a power for a proper purpose

Section 135 Reckless trading

A director of a company must not—
(a) agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or
(b) cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

Section 136 Duty in relation to obligations

A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

Section 137 Director's duty of care

A director of a company, when exercising powers or performing duties as a director, must exercise the care, diligence, and skill that a reasonable director would exercise in the same circumstances taking into account, but without limitation,—

(a) the nature of the company; and

(b) the nature of the decision; and

(c) the position of the director and the nature of the responsibilities undertaken by him or her.

Section 292 Insolvent transaction voidable

(1) A transaction by a company is voidable by the liquidator if it—

  (a) is an insolvent transaction; and

  (b) is entered into within the specified period.

(2) An **insolvent transaction** is a transaction by a company that—

  (a) is entered into at a time when the company is unable to pay its due debts; and

  (b) enables another person to receive more towards satisfaction of a debt owed by the company than the person would receive, or would be likely to receive, in the company's liquidation.

(3) In this section, **transaction** means any of the following steps by the company:

  (a) conveying or transferring the company's property:

  (b) creating a charge over the company's property:

  (c) incurring an obligation:

  (d) undergoing an execution process:

  (e) paying money (including paying money in accordance with a judgment or an order of a court):

  (f) anything done or omitted to be done for the purpose of entering into the transaction or giving effect to it.

(4) In this section, **transaction** includes a transaction by a receiver, except a transaction that discharges, whether in part or in full, a liability for which the

receiver is personally liable under section 32(1) or (5) of the Receiverships Act 1993 or otherwise personally liable under a contract entered into by the receiver.

(4A) A transaction that is entered into within the restricted period is presumed, unless the contrary is proved, to be entered into at a time when the company is unable to pay its due debts.

(4B) Where—

(a) a transaction is, for commercial purposes, an integral part of a continuing business relationship (for example, a running account) between a company and a creditor of the company (including a relationship to which other persons are parties); and

(b) in the course of the relationship, the level of the company's net indebtedness to the creditor is increased and reduced from time to time as the result of a series of transactions forming part of the relationship;

then—

(c) subsection (1) applies in relation to all the transactions forming part of the relationship as if they together constituted a single transaction; and

(d) the transaction referred to in paragraph (a) may only be taken to be an insolvent transaction voidable by the liquidator if the effect of applying subsection (1) in accordance with paragraph (c) is that the single transaction referred to in paragraph (c) is taken to be an insolvent transaction voidable by the liquidator.

(5) For the purposes of subsections (1) and (4B), **specified period** means—

(a) the period of 2 years before the date of commencement of the liquidation together with the period commencing on that date and ending at the time at which the liquidator is appointed; and

(b) in the case of a company that was put into liquidation by the court, the period of 2 years before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date on which, and at the time at which, the order was made; and

(c) if—

(i) an application was made to the court to put a company into liquidation; and

(ii) after the making of the application to the court a liquidator was appointed under paragraph (a) or paragraph (b) of section 241(2),—

the period of 2 years before the making of the application to the court together with the period commencing on the date of the

making of that application and ending on the date and at the time of the commencement of the liquidation.

(6) For the purposes of subsection (4A), **restricted period** means—

(a) the period of 6 months before the date of commencement of the liquidation together with the period commencing on that date and ending at the time at which the liquidator is appointed; and

(b) in the case of a company that was put into liquidation by the court, the period of 6 months before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date on which, and at the time at which, the order of the court was made; and

(c) if—

(i) an application was made to the court to put a company into liquidation; and

(ii) after the making of the application to the court a liquidator was appointed under paragraph (a) or paragraph (b) of section 241(2),—

the period of 6 months before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date and at the time of the commencement of the liquidation.

Section 301 Power of court to require persons to repay money or return property

(1) If, in the course of the liquidation of a company, it appears to the court that a person who has taken part in the formation or promotion of the company, or a past or present director, manager, administrator, liquidator, or receiver of the company, has misapplied, or retained, or become liable or accountable for, money or property of the company, or been guilty of negligence, default, or breach of duty or trust in relation to the company, the court may, on the application of the liquidator or a creditor or shareholder,—

(a) inquire into the conduct of the promoter, director, manager, administrator, liquidator, or receiver; and

(b) order that person—

(i) to repay or restore the money or property or any part of it with interest at a rate the court thinks just; or

(ii) to contribute such sum to the assets of the company by way of compensation as the court thinks just; or

(c) where the application is made by a creditor, order that person to pay or transfer the money or property or any part of it with interest at a rate the court thinks just to the creditor.

(2) This section has effect even though the conduct may constitute an offence.

(3) An order for payment of money under this section is deemed to be a final judgment within the meaning of section 17(1)(a) of the Insolvency Act 2006.

(4) In making an order under subsection (1) against a past or present director, the court must, where relevant, take into account any action that person took for the appointment of an administrator to the company under Part 15A.

Trusts Act 2019 provisions

Section 81 Trustee's liability for expenses and liabilities incurred, and trustee's right of indemnity

(1) A trustee is personally liable for an expense or a liability incurred by the trustee when acting as a trustee.

(2) However, a trustee who incurs an expense or a liability when acting reasonably on behalf of the trust is entitled,—

(a) if the trustee has paid the expense or discharged the liability out of the trustee's own funds, to reimbursement from the trust property; or

(b) in any other case, to pay the expense or discharge the liability directly from the trust property (or to have it paid or discharged by a remaining trustee).

(3) The operation and enforcement of the indemnity in this section is governed by the rules of the common law and equity relating to trusts.

(4) This section does not limit any indemnity available at common law or in equity.

Section 86 Creditor's limited claim to trust property through trustee's indemnity

(1) This section applies if a trustee incurs an expense or a liability to a creditor and the trustee—

(a) has a right to be indemnified from the trust property; or

(b) for any reason is not entitled to be indemnified or fully indemnified from the trust property (for example, because the trustee incurred the liability in breach of trust) but—

(i) the creditor has given value; and

(ii) the trust has received a benefit from the transaction between the trustee and the creditor; and

(iii) the creditor has acted in good faith.

(2) The creditor has a claim against the trustee that may be satisfied by the creditor being indemnified from the trust property as if the creditor were in the position of a trustee who has a right to be indemnified from the trust property.

(3) The creditor has not acted in good faith for the purposes of subsection (1)(b)(iii) if the creditor had knowledge of the circumstances that excluded or limited the trustee's indemnity (whether or not the creditor knew they would have that effect).

(4) For the purposes of subsection (1)(b), a claim under this section—

(a) is limited to the benefit received by the trust (together with interest calculated in accordance with Schedule 2 of the Interest on Money Claims Act 2016); and

(b) must be paid in priority over any payment to a beneficiary, unless the court orders otherwise; and

(c) does not alter the priority of creditors who are entitled to claim from the trust property.

(5) This section applies in respect of a former trustee who incurs an expense or a liability as a trustee acting on behalf of the trust.

Trusts Act 1973 (Qld)

Section 113 Remedies for wrongful distribution of trust property

(1) In any case where a trustee has wrongfully distributed trust property any person who has suffered loss by that distribution may enforce the same remedies against the trustee and against any person to whom the distribution has been made as in the case where a personal representative has wrongfully distributed the estate of a deceased person.

(2) Except by leave of the court, no person who has suffered loss by reason of the wrongful distribution of trust property or of the estate of a deceased person may enforce any remedy against any person to whom such property or estate has been wrongfully distributed until the person has first exhausted all remedies which may be available to the person against the trustee or personal representative.

(3) Where any remedy is sought to be enforced against a person to whom a wrongful distribution of trust property or the estate of a deceased person has been made and that person has received the distribution in good faith and has so altered the person's position in reliance on the propriety of the distribution that, in the opinion of the court, it would be inequitable to enforce the remedy,

the court may make such order as it considers to be just in all the circumstances.

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